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11 UNITED STATES DISTRICT COURT
12 CENTRAL DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

13 RETIRED EMPLOYEES
14 ASSOCIATION
15 OF ORANGE COUNTY, INC.,

16 Plaintiff,

17 vs.

18 COUNTY OF ORANGE,

19 Defendant.

Case No. SACV 07-1301 AG (MLgX)

**PLAINTIFF'S MEMORANDUM
OF POINTS AND AUTHORITIES
IN SUPPORT OF MOTION FOR
SUMMARY ADJUDICATION**

Date: September 15, 2008

Time: 10:00 a.m.

**Court: 10D (Hon. Andrew J.
Guilford)**

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INTRODUCTION

1 For 23 years, Orange County’s nurses, deputy sheriffs, librarians and other
2 employees gave their labor to the County and its residents in exchange for wages
3 and a package of promised benefits. One of those benefits was subsidized health
4 care upon retirement.

5 Now, when thousands of these employees have reached a stage in life where
6 they qualify for and rely upon subsidized retiree health care, the County has cut
7 them off at the knees. Rather than fulfilling its promise of subsidized retiree health
8 care, Orange County has snatched the subsidy away from the very people who for
9 decades – through their labor and their paychecks – earned this post-employment
10 benefit. The result has been an overnight increase in health care costs of, on
11 average, 48%, causing serious economic hardship to the group least able to absorb
12 a tremendous increase in its cost of living.

13 Based on the undisputed facts in this case, the County’s decision cannot
14 withstand scrutiny under state and federal constitutional provisions prohibiting
15 governmental interference in contractual rights. A government cannot deprive
16 employees of a post-retirement benefit earned through years of labor, any more
17 than it can deprive active employees of a paycheck at the end of a month’s work.
18 For decades the County recognized retiree health care to be deferred compensation,
19 a concept long established by case law. *See Allied Chemical and Alkali Workers of*
20 *America, Local Union No. 1 v. Pittsburg Plate Glass Co.*, 404 U.S. 157, 180-181
21 (1971) (“To be sure, the future retirement [health] benefits of active workers are
22 part and parcel of their overall compensation. . . .”); *Thorning v. Hollister School*
23 *Dist.* 11 Cal.App.4th 1598, 1606 (1992) (retirement health benefits, like pension
24 benefits, are “fundamental” to the bargained-for employment exchange, and as
25 such constitute “an element of compensation” entitled to Contracts Clause
26 protection.) But after thousands of County employees earned that compensation
27
28

1 by keeping their end of the bargain – providing their labor – the County reneged on
2 its end, refusing to provide the deferred compensation when it became due.

3 There is no dispute over the facts material to plaintiff Retired Employees
4 Association of Orange County’s (“REAOC’s”) claims:

- 5 • For 22 years, the County subsidized the health care costs of its retirees
6 by “pooling” retirees with active employees for rate-setting purposes,
7 thereby creating artificially lower health care premiums for retirees
8 and artificially higher premiums for active employees (“the Pooled
9 Rate Structure”).
- 10 • In negotiating with unions over the terms and conditions of
11 employment for County employees, the County repeatedly
12 characterized the subsidy that resulted from the Pooled Rate Structure
13 (“the Subsidy”) as a retirement medical benefit that the County
14 provided, and would continue to provide, as part of a package of
15 retiree health benefits promised to employees and provided to retirees.
- 16 • This longstanding practice became an implied term in the contracts
17 the County negotiated with its employee unions, setting the terms and
18 conditions of employment for its employees. *See University of*
19 *Hawaii Professional Assembly v. Cayetano*, 183 F.3d 1096, 1102 (9th
20 Cir. 1999) (long standing practice by public employer creates an
21 implied term in collective bargaining agreements).
- 22 • The Subsidy was an element of employees’ compensation, earned
23 when the employees provided their labor even though receipt of this
24 compensation was deferred until retirement.
- 25 • The Governor’s Public Employee, Post Employment Benefits
26 Commission noted that Orange County stands out for the “drastic”
27 means by which it has chosen to address the issue of escalating health
28 care costs – completely revoking a promised subsidy and thereby

1 dramatically shifting the burden of rising health care costs from the
2 County to its retirees. (See Brown Decl. ¶ 30, Exh. CC.)

3 Because the Subsidy is an element of employees' compensation, and
4 because it was an implied term of the labor agreements in effect when employees
5 retired, the federal and state constitutions prohibit the County from renegeing on its
6 promise to provide this compensation when the County's former employees are
7 finally eligible to receive it. *See Thorning*, 11 Cal.App.4th at 1606 (revocation of
8 public employees' post-retirement health benefits violates the contract clauses of
9 the United States and California Constitutions); *Cayetano*, 183 F.3d at 1102
10 (public employer's change to an implied term of employment violates federal
11 contract clause). Just last month the Washington Supreme Court confirmed that
12 retiree health benefits "constitute deferred compensation" to which retirees have "a
13 vested right" that "cannot be taken away" by a public entity employer. *Navlet v.*
14 *Port of Seattle*, 194 P.3d 221, 233 (Wash. 2008).

15 In sum while the County may be able to adjust any health care subsidies it
16 provides to *future* employees or retirees, it is not free to go back on its end of the
17 deal it made with *current* retirees after those individuals fulfilled their part of the
18 bargain. The Court therefore should grant Plaintiff's motion for summary
19 adjudication of its fifth and sixth claims.

20 STATEMENT OF FACTS

21 I. THE RELEVANT LABOR AGREEMENTS

22 From 1985 through 2007 (the "Relevant Period"), the vast majority of the
23 County's workforce was represented by labor unions. Harris Decl., ¶ 4; Patton
24 Decl., ¶ 3. The Meyers Milias Brown Act ("MMBA"), Cal. Gov't Code § 3500 *et*
25 *seq.*, governs the relationship between public employers and their unionized
26 employees. The MMBA refers to collective bargaining units as "Employee
27 Organizations," but for purposes of this discussion REAOC will refer to them as
28 "the Unions."

1 Under the MMBA, Memoranda of Understanding (“MOUs”) govern the
2 terms and conditions of employment for these unionized employees (including
3 terms relating to retirement health benefits). Cal. Gov’t Code § 3501. MOUs in
4 general (and in this case in particular) include both express terms and terms
5 implied from the parties’ practices and course of dealing. Patton Decl., ¶¶ 3-4;
6 Carlaw Decl., ¶¶ 3-4. As discussed in detail below, the MOUs in effect during the
7 Relevant Period included an implied promise that the County would provide the
8 covered employees the Subsidy during their retirement.

9 Documents called Personnel and Salary Resolutions (“PSRs”) governed the
10 terms and conditions of employment for that small portion of the County’s
11 workforce that was not represented by the Unions (mostly executive managers).
12 Patton Decl., ¶ 3; Brown Decl., ¶ 2, Exh. A (Deposition of Shelley Carlucci
13 [“Carlucci Depo.”]) at 153:14 – 154:9.

14 **II. THE SUBSIDY WAS A LONGSTANDING, CONSISTENT, WELL-** 15 **ESTABLISHED AND RECOGNIZED RETIREE MEDICAL** 16 **BENEFIT**

17 **A. The Establishment Of The Subsidy (1985)**

18 Since 1966 the County has provided its retired employees the opportunity to
19 participate in the same County-sponsored health insurance plans as active
20 employees. Patton Decl., ¶ 6; Brown Decl., ¶ 3, Exh. B (Deposition of Patricia
21 Gilbert [“Gilbert Depo”] at 31-32). The County maintained several different
22 health plans from which its active and retired employees could choose, some
23 funded by the County itself (the “Self-Funded Plans”) and some by third-party
24 HMOs (the “HMO Plans”). Harris Decl., ¶ 4.

25 From 1966 through 1984 the County set health insurance premiums
26 separately for active and retired employees. Patton Decl., ¶ 7; Harris Decl., ¶ 8.
27 The County intended that each group’s premiums cover its own claims and
28 administrative expenses. Harris Decl., ¶ 8. However, in 1984 the County
discovered that errors in claims accounting had caused a significant percentage of

1 retiree medical insurance claims to be reported as active employee claims, over a
2 period of several years. Patton Decl., ¶ 7; Harris Decl., ¶ 8; Brown Decl., ¶ 4, Exh.
3 C. As a result of this error, retirees’ rates were far too low to cover their actual
4 claims expenses—for 1984 the County estimated the shortfall at \$900,000. *Id.* In
5 fact, the claims accounting errors were so significant that retirees, rated separately,
6 had paid *lower* premiums than active employees in the same plans. *Id.*

7 In October 1984 the County considered two alternatives to address the rate-
8 setting error: (1) raise retiree premiums by 112%, making them higher than active
9 employee premiums, to reflect actual expected retiree claims expenses and to
10 recoup the entire \$900,000 deficit by the end of 1985; or (2) raise retiree premiums
11 by a more modest 72% by “pooling” active and retired employees for premium-
12 setting purposes, thus making the rates for the two groups equal. Patton Decl., ¶ 8;
13 Harris Decl., ¶ 9; Brown Decl., Exh. C. This second option would have increased
14 retiree premiums for 1985 to cover actual retiree claims expense and to recover just
15 20% of the \$900,000 reserve deficit. Patton Decl., ¶ 8; Harris Decl., ¶ 9; Brown
16 Decl., Exh. C. Active employee premiums would have covered the remainder of
17 the deficit. Patton Decl., ¶ 8; Harris Decl., ¶ 9.

18 After hearing concerns from retirees about the impact of the proposed rate
19 increases, the County chose the second option—equalizing active and retiree rates
20 by instituting a pooled rate structure (the “Pooled Rate Structure”). Patton Decl.,
21 ¶ 8; Harris Decl., ¶ 9; Brown Decl., Exh. C. As a group, retired employees were
22 older, and therefore more expensive to insure, than active employees. Harris Decl.,
23 ¶ 5; Carlucci Depo at 42-43; Brown Decl., ¶ 5, Exh. D (Deposition of Thomas
24 Beckett [“Beckett Depo”] at 15:10-16:4). Accordingly, under the Pooled Rate
25 Structure, active employees’ premiums (as a group) subsidized retirees’
26 premiums—active employee premiums were higher, and retiree premiums lower,
27 than they would have been if the County had rated each group separately. Beckett
28 Depo. at 17:2-18:6; Carlucci Depo. at 41:11 – 43:5; Harris Decl., ¶ 5. Throughout

1 the Relevant Period, the County and the Unions referred to the subsidy that
2 resulted from the Pooled Rate Structure variously as the “implied subsidy,”
3 “implicit subsidy,” “hidden subsidy,” “retiree premium subsidy,” and “pooled
4 subsidy.” REAOC will refer to it simply as “the Subsidy.”

5 The cost of the Subsidy resulted in the higher health insurance premiums
6 charged for active County employees. Harris Decl., ¶ 6. Throughout the Relevant
7 Period, the County paid most of the cost of the Subsidy (because it paid most of
8 active employee premiums). Harris Decl., ¶ 6.¹

9 **B. The Subsidy Becomes An Established Retiree Health Benefit**
10 **(1985 – 1990)**

11 From the beginning of the Relevant Period, the County, the Unions, County
12 retirees, and OCERS widely recognized the County’s practice of subsidizing
13 retiree premiums through the Pooled Rate Structure. In the late 1980s the
14 County’s Human Resources Director and other Human Resources staff frequently
15 discussed the Pooled Rate Structure and the Subsidy within the Human Resources
16 Department, with the County’s retained employee benefits consultants (Mercer,
17 Inc.), and with the Board of Supervisors and Board staff. Patton Decl., ¶ 9; Carlaw
18 Decl., ¶ 5; Harris Decl., ¶ 11; Gilbert Depo. at 26:15-25. Indeed, in 1986 and 1987
19 Mr. Patton proposed to the Board the idea of “splitting the pool” to reduce overall
20 premium costs. Patton Decl., ¶ 9. But the Board reaffirmed its policy of providing
21 the Subsidy as a retirement medical benefit. *Id.*

22 The Unions were likewise well aware of the Subsidy from the early years of
23 the Relevant Period. In the late 1980s and early 1990s, the Unions repeatedly
24 demanded additional retirement medical benefits from the County. Patton Decl., ¶
25 11; Harris Decl., ¶ 11; Carlaw Decl., ¶ 6. For years, the County responded by

26 ¹ The County paid 100% of the premiums for active employees and 75% of
27 the premiums for active employees’ dependents. Harris Decl., ¶ 6. Thus, the total
28 cost of the Subsidy was split (roughly 80%/20%) between the County and the
active employee population. *Id.*

1 pointing out that it *already* provided a valuable retiree medical benefit in the form
2 of the Subsidy. Patton Decl., ¶ 11; Harris Decl., ¶ 11; Carlaw Decl., ¶ 6. As
3 explained further below, from 1991 through 1993 the County negotiated additional
4 retiree medical benefits with the Unions; during these negotiations the County
5 classified the existing Subsidy as an element of the overall package of retiree
6 medical benefits promised and provided by the County. See *infra* Section C-1.

7 The County and its largest union—Orange County Employees Association
8 (“OCEA”)—engaged in litigation from 1986 through 1991 over OCEA’s demand
9 that the County pay retiree medical insurance premiums on the same terms as it
10 covered active employees’ premiums. See *Orange County Employees Association*
11 *v. County of Orange*, 234 Cal.App.3d 833 (1991). During that protracted litigation
12 the County made the argument (the same argument it made during labor
13 negotiations) that it already provided a retiree medical benefit through the Subsidy.
14 Patton Decl., ¶ 12; Harris Decl., ¶ 11. Indeed, in its 1991 published opinion, the
15 California Court of Appeal described the County’s Pooled Rate Structure, and the
16 Subsidy that resulted from it, as an element of the “comprehensive plan available
17 to employees and retirees”:

18 Each [health plan] option provided retirees and employees with
19 exactly the same benefits, *at the same premium cost*. County paid 100
20 percent of the premium for single active employees and 75 percent for
21 employees with dependent coverage but no part of retirees’ premiums.
22 However, because retirees, who are not rated separately from active
23 employees, present a substantially higher medical risk than active
24 employees, their premiums are lower than if they were rated
25 separately. *Thus, their rate is, in essence, subsidized by the county.*
26 *Orange County Employees Association*, 234 Cal.App.3d at 837-38
27 (emphasis added).
28

29 In 1990 the County’s outside employee benefits consultant—Mercer, Inc.—
30 worked with County employee benefits staff to prepare a document to assist the
31 Board of Supervisors in its approval of premium rates for County-sponsored plans.
32 Harris Decl., ¶ 11, Exh. A ; Brown Decl. ¶ 33, Exh. FF. The Board received this 6-
33 page document—called the County of Orange Medical Indemnity Rate

1 Requirements (“Rate Proposal”) — in open session. The Rate Proposal discussed
2 the Pooled Rate Structure and the Subsidy that resulted from it:

3 The County’s policy has been to set the required retiree contributions
4 at an amount equal to 100% of the average rate for active employees
5 and retirees. This practice has resulted in the following . . . retirees
6 not eligible for Medicare are not footing the whole bill; *they are being
7 subsidized by the County and by the active employees who contribute
8 towards dependent’s coverage.*

9 Harris Decl. ¶ 11, Exh. A (emphasis added). The document quantified the
10 projected amount of the Subsidy for the Self-Funded Plans for 1991 (\$1.5 million)
11 and explained that retiree premiums would more than *double* if the County did not
12 provide the Subsidy. *Id.*

13 Retirees, also, knew of the Pooled Rate Structure and the Subsidy from early
14 in the Relevant Period. In 1987 the County sent an employee benefits
15 representative, Ron Kautz, to a REAOC meeting to explain the Subsidy and other
16 retiree insurance matters. Brown Decl., ¶ 6, Exh. E. Mr. Kautz explained that,
17 because the County maintained the Pooled Rate Structure, retiree premiums for
18 1988 would be much lower than they would have been had retirees been rated
19 separately. *Id.* In 1991 Mr. Kautz again attended a REAOC meeting to explain the
20 effect of the Pooled Rate Structure. Brown Decl., ¶ 7, Exh. F. Mr. Harris recalls
21 giving presentations to retirees at the time that the 1993 Grant Program was
22 implemented, at which he explained the Subsidy and the Grant as separate health
23 insurance benefits. Harris Decl., ¶ 14. One retiree sent Mr. Harris a letter in 1993
24 explicitly stating that he was choosing to enroll in Orange County’s health plan,
25 rather than Ventura County’s, and that the Subsidy was a major factor in that
26 decision. Rogers Decl., ¶¶ 2-4, Exh. A.

27 Likewise, the Orange County Employees Retirement System (“OCERS”)
28 was also aware of the Subsidy from the beginning of the Relevant Period. In 1988
OCERS prepared a memorandum that described the County’s practice of
subsidizing retiree premiums through the Pooled Rate Structure, and asked for

1 assurances from the County that the Subsidy would continue if the County
2 provided a grant benefit (such as the one that was instituted in 1993). Brown
3 Decl., ¶ 8, Exh. G; ¶ 9, Exh. H. The County did provide that assurance. *Id.*, ¶ 10,
4 Exh. I.²

5 **C. The Subsidy’s Role In The Negotiation And Implementation Of**
6 **The 1993 Retiree Medical Insurance Grant Program. (1991-1993)**

7 **1. The Negotiations Leading To The 1993 Grant Program**

8 As discussed above, throughout the late 1980s the Unions demanded
9 additional retiree medical benefits, and the County countered by claiming that it
10 already provided such a benefit in the form of the Subsidy. Patton Decl., ¶ 11. In
11 1991 the County began negotiating with the Unions over a proposal to institute a
12 “grant” program that would provide a monthly fixed-dollar “stipend” for retirees to
13 use to defray health insurance premium costs. Carlaw Decl., ¶ 7. During those
14 negotiations the County repeatedly characterized the Subsidy as a retirement
15 medical benefit that the County provided, and would continue to provide, as part of
16 a *package* of retiree health benefits promised to employees and provided to
17 retirees. Patton Decl., ¶ 16; Carlaw Decl., ¶ 10. The County explained the cost of
18 providing the Subsidy and its “cash value” to each retiree and future retiree. For
19 example, a March 1991 County presentation to the Unions included a chart
20 showing the “value” of the proposed new retiree medical plan “in retirement
21 equivalent” (*i.e.*, stated in dollar amounts to equate the monthly value of the
22 medical benefits to pension dollars). Carlaw Decl., ¶ 12 & Exh. A. The County
23 listed the monthly value of the grant benefit in one column, the “Hidden Subsidy”
24

25 _____
26 ² The County and OCERS also discussed the Pooled Rate Structure and the
27 Subsidy in relation to their 2001 settlement of claims relating to the County’s
28 calculation of pension benefits (the so-called *Ventura* litigation). One item in
dispute in that settlement was how to account for and fund the future costs of the
Subsidy as a retirement health benefit. Brown Decl., ¶ 11, Exh. J.

1 benefit in another, and the “tax advantage” in a third.³ The document then
2 combined the value of the three elements to arrive at a monthly cash value for each
3 retiree, depending on years of service at retirement. *Id.* The presentation showed
4 that the cash value of the Subsidy at that time, for the County’s Indemnity Plan, as
5 \$260 per month per retiree. *Id.* A presentation from February 4, 1992 contained a
6 similar chart, only this iteration referred to the Subsidy as the “Pooled Subsidy”
7 rather than the “Hidden Subsidy.” By that time the value of the Subsidy had
8 grown to \$275 per month per retiree. Carlaw Decl. ¶ 13, Exh. B.

9 In addition to explaining the Subsidy and quantifying its cash value in
10 pension-equivalent terms, during these negotiations the County expressly and
11 repeatedly represented that it would *continue* to use the Pooled Rate Structure, and
12 provide the Subsidy, after implementation of the new grant plan.. For example,

- 13 • An August 15, 1991 negotiations memorandum regarding the proposed
14 grant plan⁴ states that “uniform rates for actives and early retirees *will*
15 *continue* . . . [c]urrent monthly subsidy is estimated at \$260 per month”
16 for Indemnity Plan enrollees. Brown Decl., ¶ 12 Exh. K(emphasis
17 added).
- 18 • The County’s negotiation notes dated February 4, 1992 contain the
19 following entry: “Questions for response from OCEA . . . Will we
20 continue to commingle benefits? Answer – Yes.” Brown Decl., ¶ 13,
21 Exh. L.

22
23
24 ³ The County used the term “Hidden Subsidy” because the Subsidy was
25 contained within the active employee premium rates, rather than being paid
26 directly to retirees. Carlaw Decl., ¶ 12. The “tax advantage” assumed that the
27 grant and Subsidy benefits would not be taxed, and assumed an average income tax
28 rate for retirees of 23%. *Id.*

⁴ At the time the County referred to the proposed plan as the “10/25” plan,
because it provided a grant each month equal to \$10 for every year of service an
employee had at the date of retirement. Carlaw Decl., Exh. D.

1 grant benefits. Patton Decl., ¶ 17; Carlaw Decl., ¶ 11. The County pushed back by
2 pointing out that it already used County money to fund the existing Subsidy.
3 Patton Decl., ¶ 17; Carlaw Decl., ¶ 11. Ultimately the Unions struck a deal with
4 the County to implement the 1993 Grant Program as an addition to the existing
5 Subsidy. Brown Decl., ¶ 33, Exh. FF.

6 **2. The Agreed Terms Of The 1993 Grant Program**

7 Under the terms of the 1993 Grant Program, retirees received a monthly
8 fixed-dollar stipend to pay all or part of their medical insurance premiums.⁶ *Id.*
9 The Grant was calculated by multiplying each employee’s years of service upon
10 retirement by a fixed dollar amount, initially \$10 in 1993 and increasing by up to
11 5% each year to adjust for medical insurance inflation. *Id.*; Harris Decl., ¶ 13. For
12 employees who left County employment before becoming eligible for retirement,
13 the 1993 Grant Program provided a one-time “lump-sum” cash-out, amounting to
14 1% of final hourly pay rate multiplied by the hours paid since the Program’s
15 adoption. *Id.* REAOC will refer to the Grant and the lump-sum payment
16 collectively as the “1993 Grant Benefits.” The 1993 Grant Program was funded
17 from (1) active employees’ contribution of 1% of their monthly gross wages; (2)
18 interest earnings on investment funds controlled by OCERS; and (3) infusions
19 from the County, when (1) and (2) were insufficient to cover program expenses.
20 Patton Decl., ¶ 14.

21 In 1993 the County and the Unions agreed to new MOU provisions to
22 govern the terms and conditions relating to the 1993 Grant Benefits, including
23 eligibility for those benefits and the active employees’ payment of 1% of their
24

25 _____
26 ⁶ From 1966 through 1978, retirees received a monthly grant to cover or
27 defray the costs of insurance (the “1966 Grant Benefit”). Harris Decl., ¶ 19. The
28 1966 Grant Benefit was removed in 1978, but on a prospective basis only—
employees who retired before 1978 retained their rights to the 1966 Grant Benefit.
Brown Decl., ¶ 31 & Exh. DD (1978 Doc)

1 wages to fund the program. Brown Decl., Exh. EE.⁷ In addition to these bilateral
2 labor agreements, the County unilaterally prepared a separate document—called
3 the “County of Orange Retiree Medical Plan” (the “1993 Plan Document”)—
4 which purports to set forth additional terms governing the 1993 Grant Program.
5 Patton Decl., ¶ 15, Exh. A (Plan Document); Harris Decl., ¶ 17.⁸ The 1993 Plan
6 Document describes the 1993 Grant Benefits and purports to place limits on the
7 rights of employees and retirees to those particular benefits. Patton Decl., ¶ 15,
8 Exh. A; Harris Decl., ¶ 17. It does not purport to affect the terms or conditions of
9 the Subsidy; indeed it does not mention the Subsidy or address the matter of
10 premium-setting methodology in any way. Brown Decl., ¶ 15, Exh. N. The
11 County did not present the 1993 Plan Document to the Unions to seek their
12 approval of its terms. Carlaw Decl., ¶ 8. Nor did the County disseminate the 1993
13 Plan Document to the Unions, or to County employees or retirees, after it was
14 adopted. Patton Decl., ¶ 15; Carlaw Decl., ¶ 8.

15 **3. The Subsidy And The Grant As Linked Benefits**

16 Although funded and administered separately, the Subsidy and the 1993
17 Grant were “linked” in an important way. As the parties conceived it, the 1993
18 Grant Program provided a monthly cash “stipend” to defray retiree premium costs,
19 while the Subsidy kept a “lid” on the amount (and annual inflation) of those
20 premiums. Carlaw Decl., ¶ 9; Crost Decl., ¶ 6. This “package” of benefits—the
21 Subsidy and the Grant Benefits—came to be known as the County’s “Retiree
22
23

24 ⁷ The same provisions were incorporated into the 1993 PSR (and every
25 subsequent PSR through 2007). These provisions remained unchanged from 1993
26 through 2007. Brown Decl., ¶ 14, Exh. M.

27 ⁸ The terms of the 1993 Plan Document were not negotiated or agreed
28 between the County and the Unions. Patton Decl., ¶ 15. The County never
attempted to incorporate those terms directly or by reference into any MOU, Crost
Decl., ¶ 7; Carlaw Decl., ¶ 8.

1 Medical Program.” Beckett Depo. at 25:14-26:2; Carlucci Depo. at 56:13-57;
2 148:5-23.

3 **D. The Subsidy As Reflected In County Financial Reports (1993 –**
4 **2007)**

5 **1. The Annual Mercer Reports (1993 – 2007)**

6 Every year from 1993 through 2007 the County and its consultants prepared
7 a Rate Proposal document (similar to the 1990 document described above), and
8 presented it to the Board of Supervisors, to assist in the process of approving the
9 following year’s health insurance premiums. In the “Retiree Rates” section of
10 *every one* of those fifteen Rate Proposals, the County (1) repeated the explanation
11 of its “practice” of maintaining a pooled rate structure; and (2) quantified the
12 amount of the Subsidy for the following year.⁹ The Executive Summary sections
13 of the seven Rate Proposals for 1995 through 2001 included the statement that,
14 “consistent with the County’s past practice,” rate adjustments for the following
15 year “would be applied across the board to all plans for both **actives and retirees.**”
16 Brown Decl., ¶ 16, Exh. O. The original documents bear the emphasis (bold font),
17 suggesting that the County wanted to draw the Board’s attention to the pooled rate
18 structure. *Id.*

19 **2. The 1998 Actuarial Report**

20 In 1998 the County and Mercer worked to prepare an actuarial report on the
21 County’s projected cost of providing the Subsidy and the 1993 Grant Benefits over
22 a 30-year period. *Id.* In that report Mercer (1) described the Subsidy that resulted
23 from the Pooled rate Structure; and (2) characterized it as one of the two retirement
24 medical “benefits” in the County’s Retiree Medical Program. *Id.*, ¶ 18, Exh. Q, at
25 3-7.

26
27 ⁹ In addition, the Rate Proposals for 1993 through 2002 included the
28 percentage by which retiree rates were being subsidized. *Id.*

3. The 2005 GASB Report

1 In 2004, the Governmental Accounting Standards Board (“GASB”)
2 announced a new accounting rule – Standard 45 (“GASB 45”). GASB 45 changed
3 how governmental employers report their future liabilities for retirement benefits,
4 other than pension benefits, that they had promised to current employees and
5 retirees. GASB referred to these as “Other (than pension) Post Employment
6 Benefits,” or “OPEB.” Brown Decl., ¶ 17, Exh. P. By definition under GASB 45,
7 OPEB are post-employment benefits that are earned by employees during their
8 active employment—as part of their total compensation—even though the benefit
9 is not provided to the employee until after he or she retires. *Id.*¹⁰ Beginning in
10 2008, GASB 45 required government agencies such as the County to report (1)
11 their total liabilities for OPEB (over a 30-year period), and (2) how much of that
12 projected liability was currently “unfunded,” that is, how much of it the agency
13 would have to fund on a “pay-as-you-go” basis.
14

15 The County determined that the Subsidy fit the definition of an OPEB under
16 GASB 45, meaning that the Subsidy was a post-employment benefit promised to
17 its employees and retirees as part of the compensation they earned during active
18 employment. Beckett Depo. at 30:19 – 31:8; 44:18 – 45:18; 47:3 – 48:14. The
19 County retained an actuarial consultant—Bartel Associates—to prepare a report on
20 the 30-year “GASB 45” liability for the Subsidy (and the 1993 Grant Benefits).
21 Brown Decl., ¶ 20, Exh. S. That report explained that “GASB 45 requires
22 recognizing OPEB (in the financial statement) as employees render service (and
23 consequently *earn the benefit*), rather than when [the benefits are] paid.” *Id.*, at 26
24 (emphasis added). It classified the Subsidy as one of these “earned during
25
26

27 ¹⁰ OPEB are primarily retiree medical insurance benefits, although life and
28 disability insurance benefits also fall under that definition. Brown Decl., Exh. P.

1 service/paid after retirement” benefits, and estimated the 30-year projected cost of
2 providing that benefit. *Id.*¹¹

3
4 **E. The County’s Negotiations With The Unions To Remove The
Subsidy From Active Employees (2005-2006)**

5 Once it determined that the Subsidy was a retirement health benefit that
6 employees earned during their active employment but received upon retirement,
7 and therefore was a reportable obligation under GASB 45, the County began
8 negotiating with the Unions to “split the pool” and eliminate the Subsidy—for
9 current employees/future retirees—from the Retiree Medical Program. During
10 these negotiations the County characterized the benefits provided under the Retiree
11 Medical Program in general, and the Subsidy in particular, as an element of the
12 *compensation* that employees earned in exchange for their service to the County.
13 Brown Decl., ¶ 21, Exh. T; Carlucci Depo., 47:22-48:1; 127:7-128:11. The County
14 proposed (and ultimately secured) a trade-off in what it called employees’ “total
15 compensation” or “global compensation”—active employees (union members)
16 would receive large wage increases, in exchange for their agreement to surrender
17 their existing rights to the future benefit of the Subsidy (as well as a significant
18 portion of the grant benefits). Crost Decl., ¶ 5; Brown Decl., ¶ 21, Exh. T;
19 Carlucci Depo., 67:14-20; 136:25-137:14.

20 In addition to treating the Subsidy as an element of employee compensation,
21 during these negotiations the County acknowledged that the promised Subsidy was
22 an implied term in the existing MOUs.¹² First, the County acknowledged that it

23
24 ¹¹ In other documents discussing the impact of GASB 45—including
25 reports to the Board of Supervisors—the County referred to the Subsidy as a
26 “benefit[] being earned in the current year” (that is, as the employee performs
27 service for the County), even though the benefit was not paid until retirement.
28 Brown Decl., ¶ 19, Exh. R.

¹² Despite the fact that the Subsidy had been provided as a retirement
medical benefit since 1985, the parties had not included express provisions in the
MOUs regarding the Subsidy, either before or after the implementation of the 1993
Grant Program. Patton Decl., ¶ 19. The County did not see any need to include an
(continued on next page)

1 was required to negotiate with the Unions under the MMBA to secure their
2 agreement to amend the MOUs to eliminate the Subsidy from their respective
3 active employee members. Brown Decl., ¶ 22, Exh. U; Carlucci Depo., 118:24-
4 119:9. Second, the County characterized its proposed elimination of the Subsidy
5 from active employee union members as a “new term” or a “changed term” from
6 the existing MOUs between the County and each respective union. Beckett Depo.,
7 48:20-50:2; Carlucci Depo., at 95:13-96:23; 97:8-98:1; 103:2-104:19. Third, the
8 parties entered into amended MOUs that included express provisions that “split the
9 pool” and terminated the Subsidy for each unions’ respective active employee
10 members. Brown Decl., ¶ 23, Exh. V; Carlucci Depo., at 95:13-96:23; 97:8-98:1;
11 103:2-104:19.¹³ In submitting these new MOUs to the Board for approval, the
12 County’s Human Resources staff flagged the new “split pool” provisions to draw
13 attention to these changes to the prior MOUs. Brown Decl., ¶ 23, Exh. V; Carlucci
14 Depo., at 95:13-96:23; 97:8-98:1; 103:2-104:19. Finally, in defending its decision
15 to include the cost of the Subsidy in a 2004 actuarial report on the County’s Retiree
16 Medical Program, the County explained that that cost *had* to be included, because
17 there was an existing “contractual agreement” to provide the Subsidy. Brown
18 Decl., ¶ 25, Exh. X at 9.

19 The parties’ historic treatment of the Subsidy as an element of earned
20 compensation and as a contractual commitment was underscored at an April 2005
21 Board of Supervisors meeting. Discussing the County’s goal of eliminating the
22 Subsidy and reducing the Grant Benefits, Supervisor Chris Norby stated that the
23 County could negotiate the proposed changes with respect to current employees,
24

25 (footnote continued from previous page)
26 express term because it recognized that the Pooled Rate Structure was an
27 established policy and practice, and as such was an implied MOU term. *Id.*
28

1 but could *not* do so with respect to those who had already retired under existing
2 and prior MOUs:

3 Certainly the commitments that the Board has made to current
4 retirees, *these legally binding contractual commitments*, do have to be
5 met. In meeting them we may have to make different kinds of
6 commitments to future employees . . .

7 Brown Decl., ¶ 26, Exh. Y at p. 20 (emphasis added). By a September 12, 2006
8 Board meeting Supervisor Norby’s position had evolved somewhat; he still
9 acknowledged the Subsidy as a benefit *promised* to current retirees over a period of
10 many years, but now claimed that the County had no choice but to break that
11 promise:

12 I can understand those that have said this [the Retiree Medical
13 Program benefits] was a promise and you’re breaking a promise. *It*
14 *was a promise. This promise was made for some of you a very, very*
15 *long time ago but if the money isn’t there we can’t create it.*

16 Brown Decl., ¶ 27, Exh. Z. at p. 73 (emphasis added).

17 **III. THE COUNTY’S UNILATERAL ELIMINATION OF THE SUBSIDY** 18 **FROM RETIREES (2008)**

19 By the end of 2006 the County had secured deals with the Unions to trade
20 large wage increases in exchange for the Unions’ agreement to surrender the
21 Subsidy for their current active employee members, effective January 1, 2008. All
22 parties agreed that the issue of current retirees’ rights to health benefits was *not* a
23 subject of those negotiations. Crost Decl., ¶ 3. Having made those deals with
24 active employees, the County *unilaterally* removed the Subsidy from retirees,
25 believing that, unlike active (represented) employees, retirees had *no rights* with
26 respect to retiree medical benefits, other than to be informed after the fact of the
27 County’s unilateral decision. Indeed, in its public deliberations over the question
28 of the vested nature of retiree medical benefits, the Board of Supervisors failed
even to consider the legal rights of retirees. Instead, in response to Board
members’ concerns about the vested status of retiree medical benefits, County
Counsel simply informed the Board that it had the authority to “negotiate” with the

1 Unions regarding *active* employees’ rights to future retirement health benefits.

2 Brown Decl., ¶ 28, Exh. AA at 52-54.

3 In eliminating the Subsidy the County shifted approximately \$10 million per
4 year in costs onto its retired employees. The impact on retirees was immediate and
5 substantial.

- 6 • Premiums increased on average for all plans by \$186 per month, or
7 \$2,239 per year. That represented a 48% increase over 2007 “pooled”
8 rates. Harris Decl. ¶ 22; Declaration of Vicki Gray (“Gray Decl.”), ¶ 3,
9 Exh. A.
- 10 • For some plans premiums nearly doubled. Harris Dec. ¶ 22; Gray Decl.
11 ¶ 3, Exh. A.
- 12 • The increase alone represented more than 8% of the average total
13 monthly pension check (\$2,200) for retired County employees. Brown
14 Decl., ¶ 29, Exh. BB.
- 15 • The harm to retirees is compounded each year, as premium *increases*
16 for the “stand alone” retiree insurance plans are much larger than they
17 would have been under the Pooled Rate Structure. Declaration of
18 Eugene L. Lutito, ¶¶ 3-4; Harris Decl., ¶ 22.
- 19 • The impact on retirees goes beyond out-of-pocket *premium* costs.
20 Many retirees were forced out of their existing health plans and into the
21 Sharewell Plan, with more affordable premiums but with *much* larger
22 deductibles than their prior coverage. Declaration of Gaylan Harris in
23 Opposition to Defendant’s Motion for Class Certification, ¶ 3. Thus,
24 for any of these retirees who incur significant medical costs, their
25 premium “savings” are consumed (or outstripped) by increased
26 deductible payments. Still other retirees have been forced to drop
27 dependents from their health plans, thus exposing their families to
28 significant increased risk. Declaration of Rita Nicolosi, ¶¶ 3-4.

1 Indeed, the Public Employee Post-Employment Benefits Commission,
2 appointed in 2006 by Governor Schwarzenegger to examine the state of public
3 employee benefits and the effects of GASB 45, noted the severity of the County’s
4 action in its 2007 report. Brown Decl., ¶ 30, Exh. CC. The Commission observed
5 that retiree health care benefits “have become an integral component of retirement
6 planning,” and that it is “devastating” to retirees “when health care benefits are
7 changed *after they retire*, since the cost of health services can easily deplete a
8 retiree’s income.” *Id.*, at 3 (emphasis added). Commenting on Orange County in
9 particular, the Commission observed the following:

10 Unlike many of the other agencies profiled in this report, Orange
11 County has addressed OPEB liabilities by choosing to *drastically*
12 change the structure of its retiree health plan to lower costs *rather*
13 *than to fund previous obligations* . . . the County has recently decided
14 to “de-pool” active employees and retirees, which will lower the
15 active employee premium *somewhat* while *greatly increasing* the
16 premium for retirees . . . [t]he consequences for retirees, however, are
17 likely to be both negative and significant.

18 Specifically, the Commission noted that the County’s decision to split the premium
19 pool “is expected to significantly increase retirees’ premiums or even prevent some
20 from being able to find affordable health care coverage on the individual market.”
21 *Id.*, at 90.

22 ARGUMENT

23 I. THE COUNTY’S UNILATERAL REMOVAL OF THE SUBSIDY 24 VIOLATED THE CONTRACTS CLAUSES OF THE FEDERAL AND 25 CALIFORNIA CONSTITUTIONS.

26 Article I, section 10 of the United States Constitution forbids a state or
27 political subdivision thereof, such as the County, to pass “any . . . Law impairing
28 the Obligation of Contracts . . .” Article I, section 9 of the California Constitution
provides that a “law impairing the obligations of contracts may not be passed.” To
make a claim for a federal or state contracts clause violation, a plaintiff must
establish that (1) it has a contractual right or relationship and (2) the law of a state
(or subdivision such as the County) “substantially impairs” that contractual right or

1 relationship. *See University of Hawaii Professional Association v. Cayetano*, 183
2 F.3d at 1107.

3 If the plaintiff establishes substantial impairment of a contract right, the
4 challenged law violates the contracts clause unless the government can meet a high
5 burden of showing that the impairment was “necessary to fulfill an important
6 public purpose” and that there were no available alternatives to accomplish that
7 purpose. *Id.* A government agency’s desire to save money will not justify
8 contractual impairment under this standard. *Id.* at 1107. Alternatively, with
9 respect to changes to retirement benefits programs, the government can seek to
10 justify the impairment by demonstrating that the change was “reasonable” and that
11 any disadvantages to beneficiaries were offset by “comparable new advantages.”
12 *See Betts v. Board of Administration*, 21 Cal.3d 859, 864 (1978).

13 As explained below, all County Retirees enjoyed a right to the Subsidy as a
14 matter of contract law. The County’s unilateral removal of the Subsidy
15 substantially impaired that right (indeed, it totally destroyed it). The County’s
16 proffered explanations in no way justify that impairment, and the County failed to
17 offset the retirees’ loss with any “new advantages.”

18 **II. COUNTY RETIREES HAD A CONTRACTUAL RIGHT TO THE** 19 **SUBSIDY.**

20 While the rights of public employees are generally controlled by statute, a
21 public employee has a vested *contractual* right to compensation—wages *or*
22 benefits—that the employee has earned in exchange for providing his or her
23 services to the agency. *Olson v. Cory*, 27 Cal.3d 532, 538 (1980). “Public
24 employment gives rise to certain obligations which are protected by the contract
25 clause of the Constitution, including the right to the payment of salary which has
26 been earned.” *Kern v. City of Long Beach*, 29 Cal.2d 848, 853 (1947); see also
27 *Olson v. Cory*, 27 Cal.3d 532, 538 (1980); *Betts v. Board of Administration*, 21
28 Cal.3d 859, 863-66 (1978).

1 Contracts clause protection extends beyond an employee’s right to the
2 payment of wages; it applies as well to other rights that constitute a component of
3 employees’ “contemplated compensation.” *Kern*, 29 Cal.2d at 853; *Miller v. State*,
4 18 Cal.3d 808, 815 (1977). By the County’s own admission, and under applicable
5 legal standards, the Subsidy qualifies as an element of compensation.

6 **A. Retirement Health Benefits Are A Component Of Compensation**

7 Courts have long recognized that in modern employment relationships
8 “compensation” includes non-wage benefits that are earned during employment but
9 not “paid” by the employer until a later date. In *Suastez v. Plastic Dress-Up Co.*,
10 31 Cal.3d 774, 780 (1982), the California Supreme Court noted the “increasingly
11 complex use of compensation in the form of ‘fringe benefits,’ some types of which
12 are not payable until a time subsequent to the work which earned the benefits.”

13 The earliest decisions extending contracts clause protection to deferred
14 compensation involved pension benefits. “Pension rights . . . are deferred
15 compensation earned immediately upon the performance of services for a public
16 employer and cannot be destroyed . . . without impairing a contractual obligation.”
17 *Miller*, 18 Cal.3d at 814. Thus, an employee “is not fully compensated upon
18 receiving his salary payments because, in addition, he has then earned certain
19 pension benefits, the payment of which is to be made at a future date.” *Miller*, 18
20 Cal.3d at 815. An employer may not eliminate a retiree’s pension benefits “any
21 more than it can refuse to make the salary payments which are immediately due.”
22 *Id.*¹⁴

23 While pension benefits were the earliest benefits to be recognized as a form
24 of delayed compensation, for decades courts have recognized the critical role that
25

26 ¹⁴ This is not to say that retirement benefits are immutable. An employer
27 may make reasonable and necessary adjustments *provided that* any disadvantage to
28 the beneficiary is offset by “comparable new advantages.” REAOC will discuss
the application of this doctrine in section IV, *infra*.

1 retirement *health* benefits play in the exchange of labor and remuneration between
2 employer and employee. In *Thorning v. Hollister School Dist.* 11 Cal.App.4th
3 1598, 1606 (1992), the California Court of Appeal recognized that “[t]he principle
4 that an employee begins earning pension rights from the day he starts employment
5 is not limited simply to pension cases but extends to other types of benefits.”
6 Retirement health benefits, like pension benefits, are “fundamental” to the
7 bargained-for employment exchange, and as such constitute an “an element of
8 compensation” entitled to contracts clause protection. *Id.*¹⁵; *see also Creighton v.*
9 *Regents of U.C.*, 58 Cal.App.4th 237, 243 (1998) (noting that pension and
10 retirement health benefits are protected as compensation under the *Kern/Betts*
11 doctrine); Opinion of the Attorney General of the State of California, 67 Ops. Cal.
12 Atty. Gen. 510, 1984 WL 162101 (Cal.A.G. 1984) (health benefits that were in
13 place at time of board members’ retirement constituted an element of their
14 compensation, and as such were contractually protected under *Betts, supra*).

15 Numerous other courts have recognized that retirement health benefits are a
16 contractually-protected element of employee compensation. Indeed, 37 years ago,
17 the United States Supreme Court observed: “To be sure, the future retirement
18 [health] benefits of active workers are part and parcel of their overall compensation
19 . . .” *Allied Chemical and Alkali Workers of America, Local Union No. 1 v.*
20 *Pittsburg Plate Glass Co.*, 404 U.S. 157, 180-181 (1971). The Court went on to
21 note that, “[u]nder established contract principles, vested retirement rights may not
22 be altered without the pensioner’s consent” and that a retiree “would have a federal
23 remedy . . . for breach of contract if his benefits were unilaterally changed.” *Id.*, at
24 182.

25 _____
26 ¹⁵ In reaching its conclusion, the *Thorning* court noted the “fundamental”
27 nature of retirement health benefits—the fact that they were provided as part of an
28 official employment policy relating to remuneration, and were important to the
retirees as “an inducement for their continued service . . . and as a factor in their
decision to retire.” *Id.*, at 1607.

1 The California Supreme Court similarly observed, long ago, that pension
2 *and other* retirement benefits were a “form of deferred compensation,” which “do
3 not derive from the beneficence of the employer, but are properly part of the
4 consideration earned by the employee.” *Suastez*, 31 Cal.3d at 780. In *Suastez*, the
5 Court considered whether the right to accrued vacation pay was “vested,” for
6 purposes of applying a state law forbidding an employer’s removal of “vested
7 vacation time.” *Id.* The Court concluded that vacation pay *was* a vested benefit
8 because, *like retirement benefits*, it was a form of delayed compensation for
9 services rendered. *Id.* The California Court of Appeal has applied the reasoning of
10 *Suastez* in the context of public sector employment. *See Kistler v. Redwood*
11 *Community College Dist.*, 15 Cal.App.4th 1326, 1332 (1993).¹⁶

12 The observation of the high courts has been echoed by a number of other
13 federal courts. In *International Union, UAW v. Yard-Man, Inc.*, 716 F.2d 1476,
14 1482 (6th Cir. 1983), the court observed that retiree health benefits are by their
15 nature “status benefits” which “as such, carry with them an inference that they
16 continue so long as the prerequisite status is maintained.” Thus, “when the parties
17 contract for benefits which accrue upon achievement of retiree status, there is an
18 inference that the parties likely intended those benefits to continue as long as the
19 beneficiary remains a retiree.” *Id.*; *see also, e.g., Vizcaino v. Microsoft Corp.*, 120
20 F.3d 1006, 1014 (9th Cir. 1997) (employee benefits are provided “for the purpose
21 of inducing the further rendering of services”); *Maurer v. Joy Technologies*, 212
22 F.3d 907, 915 (6th Cir. 2000) (retirement health benefits “are typically understood
23 as a form of delayed compensation or reward for past services”); *Keefer v. H.K.*

24
25 ¹⁶ The *Kistler* court noted the distinction between private and public sector
26 employment, but adopted the *Suastez* reasoning because (1) the *Suastez* Court had
27 “employed general principles of law” in determining that accrued vacation pay
28 constituted deferred compensation; and (2) had cited a public-sector case—*Bonn v. California State University*, 88 Cal.App.3d 985 (1979)—in reaching its decision. *Kistler*, 15 Cal.App.4th at 1331-32.

1 *Porter Co.*, 872 F.2d 60, 64 (same); *Gilbert v. Doehler-Jarvis, Inc.*, 87 F.Supp.2d
2 788, 792 (N.D. Ohio 2000) (“Retirement [health] benefits are typically understood
3 as a form of delayed compensation for present services, for which workers forego
4 present wages.”).

5 Several state supreme courts have reached the same conclusion. *See Navlet*
6 *v. Port of Seattle*, 194 P.2d 221 (S.Ct. Wash. 2008) (“In the reality of the
7 employment relationship, welfare [health] benefits make up a part of the core
8 compensatory benefits package offered in exchange for continued service.”);
9 *Duncan v. Retired Employees of Alaska, Inc.*, 71 P.3d 882, 888 (S.Ct. Alaska 2003)
10 (retiree medical insurance “is also part of an employee’s benefit package and the
11 whole package is an element of the consideration that the state contracts to tender
12 in exchange for services rendered by the employee”); *Roth v. City of Glendale*, 237
13 Wis.2d 173, 185 (S.Ct. Wis. 2000) (“Bargained-for benefits” such as retirement
14 health benefits “are not gratuities handed to the employee, but rather deferred
15 compensation for past services rendered”).

16 The County itself has historically acknowledged the compensatory and
17 vested nature of retirement health benefits. The County officials who were most
18 closely involved with the implementation of the Subsidy in 1985, the
19 administration of County health plans from 1985 through 1995, and the labor
20 negotiations related to the implementation of the 1993 Grant Program *all* confirm
21 that it was the County’s historic practice to treat retiree health benefits to be *vested*
22 benefits, in the sense that they could not be significantly reduced or eliminated
23 with respect to existing retirees. Patton Decl., ¶ 21; Carlaw Decl., ¶ 16; Harris
24 Decl., ¶ 21; Scott Decl., ¶ 6.

25 The historical record confirms this testimony. Indeed, prior to its decision to
26 eliminate the Subsidy from current retirees in 2008, the County had a consistent
27 practice of recognizing the vested nature of retirement health benefits by
28

1 preserving those benefits for current retirees whenever it made significant changes
2 to its retiree medical benefits program.¹⁷

- 3 • From 1966 through 1978 the County gave retirees a monthly “grant” to
4 defray health insurance premiums (the “1966 Grant”). Harris Decl., ¶ 19.
5 When the County decided to terminate that plan in 1978, it did so on a
6 *prospective* basis only; current retirees continued to receive the grant for
7 their lifetime, while future retirees would not be eligible. *Id.*
- 8 • When the County implemented the 1993 Grant Program, it considered what
9 to do with the retirees who were still receiving the 1966 Grant. Harris Decl.,
10 ¶ 19. The County wanted to be certain that these retirees relinquished their
11 existing grant in exchange for receipt of the new one. *Id.* However, the
12 County recognized that the 1996 Grant was “vested” as to those retirees. *Id.*
13 The County considered sending “waivers” for each 1966 Grant recipient to
14 sign as a condition of enrolling in the 1993 Grant Program, but ultimately
15 decided that it would be lawful to make the relinquishment of the 1966
16 Grant automatic upon the retirees’ enrollment in the new program. *Id.*¹⁸
- 17 • In 1987 the County decided to close its original indemnity health insurance
18 plan, called Indemnity A. Harris Decl., ¶ 19. The County was concerned,
19 however, that this might be considered a reduction in vested benefits for
20 current retirees who were enrolled in that plan. *Id.* The County decided to
21

22 ¹⁷ See *Jensen*, 38 F.3d at 951 (employer’s “policy of not changing the
23 benefits of prior retirees” is “consistent with the concept of vested benefits”);
24 *Angotti*, 2006 WL 1646135 at *10 (N.D. Cal. 2006) (“Rexam’s conduct prior to
25 this dispute, which never involved a significant termination or reduction in
26 benefits, is consistent with [witness] testimony that retiree health benefits were a
continuing, bargained-for obligation rather than a benefit provided at Rexam’s
pleasure.”).

27 ¹⁸ This was because the retirees had a choice to keep the 1966 Grant instead
28 of taking the 1993 Grant, and because the 1993 Grant Program offered much
greater benefits than the existing program. Harris Decl., ¶ 19.

1 close the plan for *future* enrollees, but allow then-current enrollees to
2 remain. *Id.*

3 **A. The Subsidy Was A Recognized Retirement Health Benefit.**

4 From its institution in 1985 until the day it was eliminated in 2008, the
5 parties recognized and treated the Subsidy as a retiree medical benefit. In the
6 earliest years the County, the Unions and retirees were aware that the practice of
7 pooling active and retired employees created a premium structure that significantly
8 benefited retirees, at a significant cost to the County. Patton Decl., ¶ 9. In 1991
9 the Court of Appeals expressly noted that the County “subsidized” retiree medical
10 insurance through the pooled rate structure, as part of the “comprehensive [health
11 insurance] plan offered to employees and retirees.” *OCEA*, 234 Cal.App.3d at
12 837-38. In the labor negotiations leading to the implementation of the 1993 Grant
13 Program the County pointed to the Subsidy as a retirement benefit with an
14 identifiable and significant monthly “cash value” that could be measured in terms
15 of the monthly cash value of pension benefits. Carlaw Decl., ¶¶ 12-15. At the
16 same time the County, the Unions and OCERS expressly “linked” the Subsidy
17 benefit to the 1993 Grant Benefit, and placed them together in the package of
18 retirement health benefits that the County promised and provided. *Id.* As early as
19 1998 the County and its benefits consultants generated actuarial and accounting
20 documents that identified the Subsidy as one of the two retirement health
21 “benefits” in the County’s Retiree Medical Program. Brown Decl., Exh. Q.

22 Finally, from 2005 through 2007, as the County was preparing to eliminate
23 the Subsidy, it repeatedly classified it as a “benefit” and an “Other Post
24 Employment Benefit.”¹⁹

25 _____
26 ¹⁹ The parties’ treatment of the Subsidy as an employment benefit is in
27 accord with judicial decisions in other related contexts. *See e.g. Erie County*
28 *Retirees Ass’n v County of Erie*, PA 220 F.3d 193, 209 (3rd Cir. 2000) (“the
ordinary meaning of the term ‘employee benefit’ [as it appears in the Age
Discrimination in Employment Act] should be understood to encompass health
(continued on next page)

1 • Mr. Beckett—the County’s public finance manager and a architect of the
2 restructuring of the Retiree Medical Program, testified that prior to the
3 restructuring the Subsidy was indeed a “benefit” provided under the Retiree
4 Medical Program. Beckett Depo., 20::5-21:2.

5 • The County’s 2006 Request for Proposal for litigation counsel, to provide
6 advice relating to restructuring of the Retiree Medical Program, states that
7 the County “currently offers the following *post-employment benefits*: (1)
8 County of Orange Retiree Medical Plan . . . [and] 2. Health Insurance Rate
9 Pooling.” Brown Decl., ¶ 36, Exh. II (emphasis added). Under “Health
10 Insurance Rate Pooling,” the County describes the Subsidy as follows:

11 Although not expressly included in the Plan or any memorandum of
12 understanding or other agreement with employee bargaining units, for the
13 purposes of determining health care premium rates, the County has pooled
14 both current employees and retirees. Under this *program*, current County
15 employees and retirees pay the same premium rates.” *Id.* (emphasis added).

16 **B. The Parties Recognized And Treated The Subsidy As An
17 Element Of Compensation.**

18 The fact that retiree medical benefits like the Subsidy constitute an element
19 of *compensation* was clearly reflected in the course of dealing between the County
20 and the Unions. Indeed, over a period of decades the County has declared the
21 Subsidy an element of compensation, whenever it suited its own financial and
22 labor-relations purposes.

23 In the negotiations leading to the institution of the 1993 Grant Program, the
24 County and the Unions recognized the Subsidy as an important, bargained-for
25 benefit: part of the new “package” of retiree medical benefits—the Subsidy and the
26 Grant—that employees would receive as part of the new bargain struck by the

27 (footnote continued from previous page)
28 coverage and other benefits which a retired person receives from his or her former
employer”).

1 parties regarding the surplus ARBA funds and the new Grant Program. Carlaw
2 Decl., ¶¶ 10-15.

3 Fourteen years later, when the County sought to restructure the Retiree
4 Medical Program, the County explicitly acknowledged that the Subsidy was an
5 element of the “total compensation” or “global compensation” that it had been
6 providing to its employees in exchange for their services. Crost Decl., ¶ 8; Brown
7 Decl., Exh. T. The County proposed a trade-off between the existing elements of
8 employees’ global compensation package: the retirement health benefits
9 component of the package would be reduced for current employees,²⁰ while the
10 wage component would be increased. Crost Decl., ¶ 8; Brown Decl., Exh. T.

11 The County again underscored the “compensatory” nature of the Subsidy
12 when it responded to the new financial reporting requirements of GASB 45. When
13 the County was considering how to respond to the new rule, it acknowledged that
14 the Subsidy was an “OPEB,” that is, a post-employment benefit that employees
15 (1) *earned* as part of their compensation when they were active employees; but (2)
16 did not *receive* until after their retirement. Brown Decl., Exh. R at 1-2. The
17 County’s retained GASB 45 expert—Bartel Associates—prepared a report
18 explaining that “GASB 45 requires recognizing OPEB (in the financial statement)
19 as employees render service (and consequently *earn the benefit*), rather than when
20 [the benefits are] paid.” *Id.*, Exh. S at 26 (emphasis added). The report clearly
21 classified the Subsidy as one of these “earned during service/paid after retirement”
22 benefits, and estimated that the 30-year projected cost of providing that benefit.
23 *Id.* at 5, 7, 10. In other documents discussing the impact of GASB 45—including
24 reports to the Board of Supervisors—the County referred to the Subsidy as a
25 “benefit[] being earned in the current year” (that is, as the employee performs
26

27 ²⁰ Employees’ right to receive the Subsidy upon retirement would be
28 eliminated and their Grant Benefits substantially reduced.

1 service for the County), even though the benefit was not paid until retirement.

2 Brown Decl., Exh. R.²¹

3 The express recognition that the Subsidy was an element of earned
4 compensation is reinforced by the County's implicit, but nevertheless clear,
5 acknowledgements of the "vested" or "lifetime" nature of that benefit. First, for 23
6 years the County provided the Subsidy to retired employees, with no time
7 limitation whatsoever on that benefit. *See Arizona Laborers, Teamsters & Cement*
8 *Masons Local 395 v. Conquer Cartage Co.*, 753 F.2d 1512, 1517-18 (9th Cir. 1985)
9 ("In ascertaining the intent of the parties to a CBA, the trier of fact . . . may
10 consider the parties' conduct subsequent to contract formation . . . *and such*
11 *conduct is to be given great weight*") (emphasis added).

12 Second, a June 20, 2006 staff presentation to the Board of Supervisors
13 regarding the Retiree Medical Program (the Subsidy and the 1993 Grant Benefits),
14 explains that one of the "factors contributing to the current problem—revenue
15 shortfall and unfunded liability" is that "[t]he benefit is a *lifetime benefit (i.e., does*
16 *not end when the retiree attains a certain age.*" Brown Decl., Exh. U at 10
17 (emphasis added).

18 Third, throughout the Relevant Period active employees with enrolled
19 dependants paid higher premiums because of the Subsidy; approximately 20% of
20 the cost of the Subsidy was borne by active employees. Harris Decl. ¶ 6. The fact
21 that many retirees paid extra premiums during their active employment, to
22 underwrite a portion of the Subsidy, is further evidence that employees expected to
23 enjoy the benefit of the Subsidy throughout their retirement.

24 ²¹ Mercer and the County had prepared a fiscal year 2004 actuarial report
25 that did not specifically address the GASB 45 requirements. However, it did
26 explain that "the value of the subsidy provided to retirees by extending medical
27 benefits to retirees at the same rate charged to active employees" was "[i]ncluded
28 in the liabilities for retiree medical benefits." Like the 2005 report, the 2004 report
characterized the projected cost of providing the Subsidy to retirees as part of the
County's "liabilities for past service." Brown Decl., ¶ 32; Exh. EE.

1 Finally, the parties expressly linked the Subsidy to other *explicitly* vested
2 retirement benefits, pension payments and the 1993 Grant. During the Relevant
3 Period the County prepared informational booklets to distribute to its active
4 employees to inform them about their health benefits (the “Health Plan Booklets”).
5 Harris Decl., ¶ 20 & Exhs. C - E. In the Health Plan Booklets the County made
6 retirees’ right to participate in County plans and pay the pooled-rate premium,
7 contingent only on (1) retired status and (2) pension eligibility. Harris Decl., Exh.
8 C at 5 (“When you retire from the County of Orange *and receive a monthly*
9 *retirement check*, you will be eligible” to participate in County health plans at the
10 full [*i.e.* pooled] premium rate (emphasis added)). As the Ninth Circuit recognized
11 in *Bower v. Bunker Hill Co.*, 725 F.2d 1222, 1224 (1984), when an employer ties
12 eligibility for a retiree health benefit to pension eligibility, employees may be led
13 to view the duration of the health insurance benefits to be the same as that for
14 pension benefits (that is, lifelong). *Id.*, 725 F.2d at 1224; *see also Yolton*, 435 F.3d
15 at 581.

16 In sum, over decades and in multiple contexts the County has repeatedly
17 characterized the Subsidy as a bargained-for benefit and as earned compensation.
18 The County cannot now escape that classification. *See Wang v. Chinese Daily*
19 *News, Inc.*, 435 F.Supp.2d 1042, 1049 (C.D. Cal. 2006) (Marshall. J.) (employer
20 cannot deny that vacation time was “accrued,” for purposes of Labor Code
21 provision, when documents showed that employer *itself* had referred to the
22 vacation time as “accrued” and parties treated it as accrued during course of
23 dealing). As such, retirees had a contractual right to the continuation of that
24 benefit. *Kern*, 29 Cal.2d at 853; *Miller*, 18 Cal.3d 808, 815 (1977).

25 **C. The Subsidy Is An Element Of Compensation Despite The**
26 **Fact That The Parties Did Not Reduce It To a Particular**
27 **Writing.**

28 The County attempts to escape its long history of treating the Subsidy as a
key component of its Retiree Medical Program, a bargained-for benefit and an

1 element of employee compensation, by contending that the benefit was not
2 contained in any specific *written* promise. That argument is unavailing. It is well
3 established that employment agreements in general, and collective bargaining
4 agreements in particular, include express terms and terms implied from the
5 practices and course of dealing between employer and employee.

6 The Ninth Circuit has explicitly held that collective bargaining agreements
7 between public agencies and their unions must be read to include implied terms
8 derived from the parties' course of dealing. In *University of Hawaii Professional*
9 *Assembly v. Cayetano*, 183 F.3d 1096, 1102 (9th Cir. 1999), Hawaii state
10 employees brought contracts clause claims against the state university over its
11 proposal to institute "pay lags" that would allow it to change the dates on which
12 employees were paid. The applicable labor agreements contained *no* language
13 establishing on which dates each month employees were to be paid. *Id.*, at 1102.
14 However, the state had followed a practice—for 25 years—of paying employees
15 on the fifteenth and last day of each month. *Id.* at 1099. The court held that the
16 timing of each payroll payment was *by implication* "included in the collective
17 bargaining agreement," because "the State and its employees had a course of
18 dealing" regarding payment dates and "[a] course of dealing can create a
19 contractual expectation." *Id.*, at 1102.

20 In construing collective bargaining agreements, not only the language
21 of the agreement is considered, but also past interpretations *and past*
22 *practices* are probative . . . The custom and practice of the State has
23 been to pay its employees on the fifteenth and final days of each
24 month . . . we affirm the district court's determination that the timing
25 of payment is part of the collective bargaining agreement.

26 *Id.* (emphasis added); *see also AFSCME Local 2957 v. City of Benton, Arkansas*,
27 513 F.3d 874, 879 (8th Cir. 2008) ("Labor laws, however, do not require all the
28 details of particular practices to be worked out in advance," but instead must be

1 read to include terms that reflect established past practices, such as payment of
2 retiree health insurance premiums).²²

3 Applying similar reasoning, courts have reached the same conclusion—that
4 an unwritten practice or understanding between a public employer and its
5 employees can create Constitutionally-protected rights—for purposes of claims
6 brought under the due process clause.²³ In *Perry v. Sindermann*, 408 U.S. 593, 602
7 (1972), the Supreme Court held that, for purposes of finding a property interest
8 protected by the due process clause, “[e]xplicit contractual provisions may be
9 supplemented by other agreements *implied from the promisor’s words and conduct*
10 *in the light of the surrounding circumstances.*” (emphasis added). Applying
11 *Sindermann*, the Ninth Circuit has held that a governmental employee may have a
12 *de facto* property interest in continued employment, despite the absence of any
13 express contractual guarantee, based on the agency’s “prior treatment” of the
14
15
16

17 ²² A long line of United States Supreme Court precedents supports this
18 doctrine. *Consolidated Rail Corporation v. Railway Labor Executives’ Assn*, 491
19 U.S. 299, 311-12 (1989) (“Neither party relies on any express provision of the
20 agreement; indeed, the agreement is not part of the record before us . . . however,
21 collective-bargaining agreements may include implied, as well as express, terms
22 A collective bargaining agreement is not an ordinary contract for the purchase
23 of goods and services . . . it is a generalized code to govern a myriad of cases
24 which the draftsmen cannot wholly anticipate . . . [i]n this case, Conrail's
25 contractual claim rests solely upon implied contractual terms, as interpreted in light
26 of past practice. *See also Detroit & Toledo Shore Line R. Co. v. United*
27 *Transportation Union*, 396 U.S. 142, 155 (1969) (“Where a condition is
28 satisfactorily tolerable to both sides, it is often omitted from the [collective
bargaining] agreement . . .”); *United Steelworkers of America v. Warrior & Gulf*
Navigation Co., 363 U.S. 574, 578-82 (1960) (noting the special nature of
collective bargaining agreements and rejecting the notion that an “employee’s
claim must fail unless he can point to a specific contract provision upon which his
claim is founded”)

²³ REAOC is not moving for summary judgment on its due process claims.
These due process cases are presented simply to reinforce the conclusion that an
established practice between a public employer and its employees can give rise to
implied-in-fact rights that are protected by the Constitution.

1 employee or other similarly-situated employees. *Orloff v. Cleland*, 708 F.2d 372,
2 377 (9th Cir. 1983).²⁴

3 Here, evidence extrinsic to the written terms of the MOU—including
4 collateral documents, the parties’ course of dealing and the County’s own
5 admissions—leaves no doubt that the MOUs contained an implied promise that
6 employees, upon retirement, would continue to participate in County health
7 insurance plans, at the same premium rates as active employees.

8 **1. The Health Plan Booklets**

9 The express provisions of the MOUs and PSRs are silent on the question of
10 the duration of retired employees’ rights to participate in County-sponsored health
11 plans at premium rates that reflect the Subsidy. However, in construing collective
12 bargaining agreements, courts look to related “collateral” documents for evidence
13 of the substance of the parties’ understanding. *See Senior v. NSTAR*, 449 F.2d 206,
14 219-21 (1st Cir. 2006). The Health Plan Booklets that the County prepared and
15 distributed to employees included explicit references to employees’ rights to
16 continue to participate in County health plans *after* retirement. The 1994 Health
17 Plan Booklet informed employees that, “[w]hen you retire from the County you
18 will be eligible to continue with the health insurance plans.” Harris Decl., Exh. C.
19 The 1996 and 1999 versions were more detailed on the subject, and expressly tied
20 eligibility for retiree health insurance benefits to eligibility for pension benefits:
21 “When you retire from the County of Orange and receive a monthly retirement
22 check, you will be eligible to continue your enrollment in one of the County health
23 insurance plans.” Harris Decl., Exh. D and E.

24 ²⁴ Other circuits are in accord. *See, e.g., Yashon v. Gregory*, 737 F.2d 547,
25 553-54 (6th Cir. 1984) (under *Sindermann*, “an employee may still have a property
26 interest in continued employment if an agreement between the employer and the
27 employee can be implied or if the unwritten ‘common law’ of the work place
28 demonstrates that certain employees are entitled to continued employment”); *Vail*
v. Board of Education of Paris Union School District, 706 F.2d 1435, 1437-38 (7th
Cir. 1983).

1 The Health Plan Booklets also addressed the specific matter of retiree
2 premiums. The 1994 booklet stated that “[r]etiree rates are based on the full
3 premium with adjustments for Medicare.” *Id.*, Exh. C (emphasis added). The
4 1996 and 1999 versions provided that “[r]etiree rates are based on the full monthly
5 premiums for each plan, with adjustments for Medicare enrollment.” *Id.*, Exh. D,
6 E (emphasis added).²⁵ The terms “full premium” and “full monthly premiums for
7 each plan” are not defined in the Health Plan Booklets. However, the County
8 official who oversaw the preparation of these booklets explains that the term “full
9 premium” as used in the Health Plan Booklets meant full *pooled* premium. Harris
10 Decl., ¶ 20. Indeed, no other interpretation of that term is consistent with the
11 County’s practice of maintaining a single, commingled premium pool for each
12 plan, a practice that was established a decade before the 1994 booklet was
13 prepared, maintained through the preparation of the 1996 and 1999 booklets, and
14 then for 8 years after that.²⁶

15 2. Past Practice and Course of Dealing

16 When determining whether a practice has become an implied term of a
17 collective bargaining agreement, courts examine whether the practice was: (1)
18 longstanding; (2) established and recognized; (3) consistently applied; (4)
19 significant; and (5) a subject of bargaining. *See Cayetano*, 183 F.3d 1096 (practice
20 became an implied term because it was longstanding, significant and subject to
21

22 ²⁵ The reference to Medicare “adjustment” pertained to the County’s
23 practice of providing a discount for Medicare-enrolled participants, over and above
24 the discount inherent in their pooled rates. Harris Decl., ¶ 20.

25 ²⁶ In the same booklet the County provided that *active* employees on
26 unpaid leave of absence had to pay the “full cost of the health insurance premium”
27 to remain covered under their County plan. The terms “full premium,” “full
28 monthly premium” and “full cost” of the premium must be read to mean the same
thing in the same document, and they can only refer to the *pooled* premium under
each plan. The term “full premium” was likewise defined as full *pooled* premium
for other purposes, such as the calculation of COBRA premium payments due from
former employees (full pooled premium + 2%). Harris Decl., ¶ 20.

1 bargaining); *Brotherhood of Maintenance of Way Employees v. Chicago & North*
2 *Western Transp. Co.*, 827 F.2d 330, 334 (8th Cir. 1987) (“by virtue of the parties’
3 longstanding and recognized custom and practice,” employer’s right to discipline
4 employees for drug use “has become an implied term in the agreement of the
5 parties”) (emphasis added); *Railway Labor Executives*, 833 F.2d at 705 (“parties’
6 collective bargaining agreement . . . includes both the specific terms set forth in the
7 written agreement and any well established practices that constitute a course of
8 dealing” between the parties) (emphasis added); *Bonnell/Tredegear Indus.*, 46 F.3d
9 at 344 (“CBAs may have express as well as implied terms. . . [a]n employer’s
10 established past practice can become an implied term of a CBA . . . [p]ast practices
11 rise to the level of an implied agreement when they have ripened into an
12 established and recognized custom between the parties”) (emphasis added).²⁷
13 *Every one* of those factors weighs decisively in favor of finding that the Subsidy
14 was an implied MOU term.

15 **a. Longstanding, Established and Recognized**

16 There is no dispute that the County’s practice of subsidizing retiree
17 premiums through the Pooled Rate Structure was longstanding, consistently
18 applied and frequently applied. Indeed, the practice was followed every year—
19 without exception and without interruption—for 23 years. See *Cayetano*, 183 F.3d
20 at 1102 (state’s twenty-five-year practice of paying employees on fifteenth and
21 final day of each month became an implied term in the collective bargaining
22 agreement); *Youngman v. Nevada Irrigation District*, 70 Cal.2d 240, 246-47
23 (1969) (public employer’s *two year* practice of granting annual salary increases
24 was sufficient to state a claim for breach of an implied promise to continue to grant
25 such increases); *City of Benton*, 513 F.3d 874 (8th cir. 2008) (city’s fifteen-year
26 practice of paying 100% of retirees’ medical insurance premiums ripened into a

1 term of the collective bargaining agreements, despite absence of clear contract
2 language on the subject of retirement medical benefits); *Intermountain Rural Elec.*
3 *Assoc.*, 984 F.2d at 1568 (seven-year practice of using paid time off as part of
4 overtime pay calculation became an implied term of collective bargaining
5 agreement); *Bonnell/Tredegear Indus.*, 46 F.3d at 343-45 (employer’s use of same
6 formula to determine Christmas bonus for over eighteen years became a term of
7 the collective bargaining agreement, despite absence of written provisions
8 governing calculation of such bonuses).

9 Neither can there be any dispute that the practice was “established and
10 recognized.” In the late 1980s the County used the Subsidy as a bargaining chip
11 during negotiations with the Unions, over their demand that the County provide
12 retirement medical benefits *in addition to* the benefits already provided. During
13 those negotiations, the County: (i) referred to the Subsidy as a “benefit” (separate
14 from the proposed Grant benefit); (ii) quantified for the Unions how much the
15 Subsidy was worth, each month, to each retiree; (iii) quantified how much it cost
16 the County to provide the Subsidy; and (iv) represented that the County would
17 *continue* to provide the Subsidy as a retirement medical benefit—as a separate
18 benefit—after the 1993 Grant Plan went into effect. Carlaw Decl., ¶¶ 12-15.

19 During that same time period the County took the position—in briefs before
20 the Superior Court and Court of Appeals—that the Subsidy was a retirement
21 medical benefit that it already provided to its employees and retirees (the County
22 made that argument to convince the courts that it was not required to meet the
23 Unions’ demand for additional retirement medical benefits). Patton Decl., ¶¶ 11-
24 12. The Court of Appeal noted in 1991 that the County subsidized retiree
25 premiums through the Pooled Rate Structure, as part of the County’s
26 “comprehensive plan available to employees and retirees.” *OCEA*, 234 Cal.App.3d
27 at 837-38. Also beginning in the late 1980s County gave presentations to retirees
28

1 at REAOC meetings, at which it clearly explained the benefit they were receiving
2 by virtue of the pooled rate structure. Brown Decl., Exhs. E, F; Harris Decl., ¶ 11.

3 Throughout the Relevant Period the Subsidy was repeatedly identified,
4 quantified, dissected, and analyzed, in annual reports that formed the basis for the
5 Board’s premium-setting decision. The County and its benefits consultants
6 prepared no fewer than 16 annual Rate Proposals—over a 16-year period-- that
7 stated that “the County’s *policy* has been” to pool actives and retirees for rate-
8 setting purposes and that “this *practice* has resulted in” the Subsidy. Brown Decl.,
9 Exh. O (emphasis added). Punctuating these annual public reports were periodic
10 actuarial reports that identified the Subsidy as a retiree medical benefit, quantified
11 the historic cost of providing it, and projected those costs into the future. Brown
12 Decl., Exhs. Q, EE.

13 Once the County began considering the elimination of the Subsidy, it clearly
14 classified it as (1) a retirement medical benefit; (2) a critical (and costly)
15 component of the Retiree Medical Program; (3) an element of employee
16 compensation; and (4) a binding “term or condition of employment” under the
17 MMBA that could not be changed except through negotiation.

18 **b. Significant**

19 The Subsidy was a “significant,” indeed a *critical*, retirement benefit. The
20 value of the Subsidy in 2007 was on average \$186 per month per retiree,
21 approximately 8% of each retiree’s *total* monthly pension check. By any measure
22 the elimination of the Subsidy created a “significant” increase in the amount that
23 retirees had to pay for health insurance.²⁸ There is likewise no doubt that the
24 Subsidy was significant to the County; indeed the County contends (albeit

25 ²⁸ In *Cayetano*, the Ninth Circuit concluded that Hawaii’s practice of paying
26 university employees on the fifteenth and final days of each month was of
27 sufficient importance to employees to qualify as an implied MOU term. 183 F.3d
28 1096. A fortiori, the elimination of a benefit (and the resulting drastic increase in
the cost of health insurance) meets the “significance” test.

1 implausibly) that the cost of providing the benefit was creating a fiscal crisis that
2 required the elimination of the Subsidy.²⁹

3 **c. Negotiable**

4 The Subsidy was a “negotiable” subject between the County and the Unions
5 throughout the Relevant Period. Indeed, the parties *did* negotiate regarding the
6 Subsidy from the late 1980s until the implementation of the 1993 Grant Program,
7 and again from 2004 through 2006 (when the County sought and obtained the
8 Unions’ agreement to surrender the Subsidy for current active employees in
9 exchange for wage increases). And the Subsidy was “subject to” negotiation, with
10 respect to active employees’ rights thereto, at any point during the Relevant Period.
11 The County has acknowledged, as it must, that the Subsidy was a topic over which
12 it was required to bargain under the MMBA.

13 **3. The County Has Admitted That The Subsidy Was An MOU**
14 **Term**

15 The County’s contention that the MOUs did not contain any reference to the
16 Subsidy is contradicted not only by the documentary evidence and the parties’
17 course of dealing. It is contrary to the County’s own admissions, both prior to and
18 during this litigation. Shelly Carlucci is the County’s designated Person Most
19 Knowledgeable on the topic of labor negotiations relating to the Subsidy. She
20 currently manages labor relations as the County’s Assistant Director of Human
21 Resources. From 1997 until 2005 she was the County’s Assistant Chief of
22 Employee Relations, and prior to that she was an Employee Relations Manager for
23 the County. Carlucci Depo. at 8:9-22; 12:4-13:20. At her PMK deposition Ms.

24 _____
25 ²⁹ The County acknowledged the “significance” of the Subsidy when it
26 recognized that the MMBA required it to bargain with the Unions in order to
27 eliminate it from active employees’ benefits package. *Claremont Police Officers*
28 *Association v. City of Claremont*, 39 Cal.4th 623, 631 (2006). (MMBA requires
negotiation only when an employer proposes to make changes that have a
“significant and adverse effect” on the terms or conditions of employment); Cal.
Gov’t Code § 3505.

1 Carlucci clearly testified that the County’s proposal to eliminate the Subsidy (by
2 splitting the pool) constituted a proposal to change the terms of the MOUs that
3 were then in effect: “We had to negotiate the changes [to the Retiree Medical
4 Program] with the labor organizations. *The program was in our MOU. We were*
5 *making changes with the MOU . . .*” *Id.* at 122:16-123:6 (emphasis added).³⁰

6 Ms. Carlucci was personally involved in the negotiations with the Orange
7 County Managers Association regarding changes to the Retiree Medical Program.
8 *Id.*, 93:22-98:1. She testified that “one of the changes [she] negotiated to the
9 MOU” between the County and that union “was the splitting of the pool.” Carlucci
10 Depo. at 96:13-23; 97:8-98:1. Paul Crost, one of the chief negotiators for OCMA
11 during those discussions, similarly recalls that the County treated the Subsidy as a
12 term in the existing MOU that had to be amended to reflect the splitting of the
13 pool. Crost Decl., ¶ 9.³¹

14 In giving this testimony, Ms. Carlucci confirmed what the County’s own
15 contemporaneous documents already made clear. When submitting a new MOU to
16 the Board for its approval, the County Human Resources department prepared a
17 “cover” document that provided a summary of the changes from the existing MOU
18 to the new one, so that the Board could focus its attention on the newly-negotiated
19 terms (as opposed to the majority of terms that would remain unchanged). Every
20 one of these “summary of changes” documents that the County has produced
21 includes a reference to the elimination of the Subsidy as one such change to the
22 prior MOU. Ms. Carlucci confirmed that, by listing it on these “summary of
23

24 ³⁰ When Ms. Carlucci’s referred to the “program,” she was including the
25 Subsidy and the 1993 Grant Benefits. *Id.* at 56:13-57:1; 148:5-23.

26 ³¹ Ms. Carlucci was also personally involved in the County’s negotiations
27 with another union—the Eligibility Workers Unit—over these changes. She
28 testified that one of the issues that she was “negotiating” with this union was the
elimination of the Subsidy, and that this “change to the MOU” was reflected in the
newly-negotiated contract. (*Id.*, 103:2-104)

1 changes” documents, the County was indicating that the elimination of the Subsidy
2 was a change to the prior MOU. Carlucci Depo., 95:10-96:23; Brown Decl., Exh.
3 V at OC000244.

4 Moreover, to further assist the Board in its review, the Human Resources
5 staff put the new MOU terms in boldface type within the body of the MOU itself.
6 Every MOU that implemented the “split pool” and the elimination of the Subsidy,
7 included the following language in bold type: “Effective January 1, 2008, active
8 employees will be separately pooled from retirees for purposes of setting premiums
9 for participation in County offered health plans.” Ms. Carlucci confirmed that the
10 use of boldface type in these MOUs indicated that the bolded term represented a
11 change from the prior MOU. Carlucci Depo. at 95:23-96:23; Brown Decl., Exh. V
12 at OC000317.

13 Ms. Carlucci’s testimony was echoed and confirmed by the testimony of
14 Thomas Mauk, the County’s Chief Executive Officer. In addition to overseeing all
15 of the negotiations that led to the elimination of the Subsidy, Mr. Mauk was
16 personally involved (that is, “at the table”) during many of those discussions. Mr.
17 Mauk testified that (1) the elimination of the Subsidy constituted a change to the
18 terms of the then-existing MOUs; and (2) that fact is evidenced by the inclusion of
19 the elimination of the Subsidy in the “summary of changes” documents and by the
20 inclusion of the “split pool” term, in bold, in the newly-negotiated MOUs. Brown
21 Decl., ¶ 34, Exh. GG (Deposition of Thomas Mauk (“ Mauk Depo”) at 93:1-94:25.

22 The County’s admission that the Subsidy reflected an implied term in the
23 MOU is consistent with its repeated acknowledgement that the elimination of the
24 Subsidy was a binding implied “term or condition of employment” under the
25 MMBA. The MMBA requires that governmental employers meet and confer with
26 labor unions over any changes that have a “significant and adverse effect” on
27 wages, hours, and other terms and conditions of employment. The County clearly
28 admitted that under the MMBA it could not eliminate the Subsidy from active

1 current employees except through negotiation with the Unions. Here again, Ms.
2 Carlucci’s testimony is clear and conclusive: “We had to negotiate the changes
3 with the labor organizations . . . we had to meet and confer with the labor
4 organizations to make those changes, and we did.” Carlucci Depo., 122:16-123:6.

5
6 **4. The MOUs Must Be Read As If They Included An *Express***
7 **Promise From The County To Provide The Subsidy As A**
8 **Retirement Benefit.**

9 The parties’ course of dealing, the County’s express promises in the Health
10 Plan Booklets, and the County’s admissions all establish that the MOUs contained
11 an implied promise on the part of the County: to permit employees, upon
12 retirement, to participate in the same County health plans as active employees and
13 pay the same premiums as active employees. That implied promise must be
14 treated as if it were an *express* promise; County Retirees’ rights to that benefit
15 deserve the same protection as rights that arise from express MOU terms.

16 *Bonnell/Tredegear*, 46 F.3d at 346 (terms derived from past practice are “as binding
17 and enforceable as an express terms of the [collective bargaining] agreement”);
18 *Youngman*, 70 Cal.2d at 246 (finding in the context of *public sector* collective
19 bargaining agreements—that “the only significant difference” between implied and
20 express contracts “is the evidentiary method by which proof of their existence and
21 terms is established.” *See also Foley v. Interactive Data Corp.*, 47 Cal.3d 654,
22 677-78 (1988) (implied in fact contracts generally “stand on equal footing” with
23 express contracts), *quoting* Restatement 2nd of Contracts, § 19 (“there is no
24 distinction in the effect of the promise whether it is expressed in writing, or orally,
25 or in acts, or partly in one of these ways and partly in others.”)).

26 **D. The County Did Not Reserve The Right To Eliminate The**
27 **Subsidy.**

28 In moving to dismiss REAOC Complaint early this year, the County
contended that the Subsidy could not have been a vested retiree health benefit
because the 1993 Plan Document contains reservation-of-rights clauses, which

1 purport to (1) foreclose vesting of any benefits provided under that Plan
2 Document; and (2) permit the County to make changes to the 1993 Grant Benefits
3 through negotiations with the Unions. *See* County’s Amended Points and
4 Authorities in Support of Motion to Dismiss. This Court denied the motion,
5 because REAOC’s claims were premised on a benefit separate from, and not
6 controlled by, the 1993 Plan Document. Order of February 12, 2008 at 6-7.

7 Because REAOC anticipates that the County will return to this argument in
8 its motion for summary judgment, REAOC will reserve its detailed response for its
9 opposition papers. However, stated *very* briefly, the County’s argument will fail
10 because: (1) by the County’s own admission, the 1993 Plan Document does not
11 even *purport* to apply to the Subsidy; by its own terms it applies *only* to the 1993
12 Grant Benefits; (2) the 1993 Plan Document cannot limit rights that arise under the
13 MOUs, because neither the document nor its reservation-of-rights provisions were
14 included, expressly or by implication, in the MOUs that set forth the *agreed* terms
15 of the 1993 Grant Program; and (3) the County never disseminated the 1993 Plan
16 Document, to the Unions or its employees.

17
18 **III. THE COUNTY SUBSTANTIALLY INTERFERED WITH
RETIREES’ RIGHTS TO THE SUBSIDY.**

19 The contracts clause forbids the County to “substantially impair” retirees’
20 contractual rights to the Subsidy. *Cayetano*, 183 F.3d at 1101. There can be no
21 doubt that the County’s *elimination* of the Subsidy worked such a “substantial”
22 impairment. *Id.* (substantial impairment test met when State switched the days of
23 each month on which it paid its employees); Gilbert Depo. at 50:3-8; Harris Decl.
24 ¶ 18.

25
26 **IV. THE COUNTY CANNOT ESTABLISH THAT ITS INTERFERENCE
WAS LAWFUL.**

27 The County will be unable to establish that its elimination of the Subsidy
28 was lawful or justified. Impairment of contractual relations may be lawful where it

1 is in response to a crisis and the government first pursued all reasonable
2 alternatives before resorting to impairment. *Cayetano*, 188 F.3d at 1107. Here,
3 while the County clearly wanted to reduce its expenditures on retiree medical
4 benefits, there is no indication that it was facing a funding emergency or that it
5 attempted to address the problem by resort to anything other than the total
6 elimination of the Subsidy. *Id.* (“A governmental entity can always find a use for
7 extra money.... if a state could reduce its financial obligations whenever it wanted
8 to spend the money for what it regarded as an important public purpose, the
9 Contract Clause would provide no protection at all.”).

10 Another justification defense exists for “reasonable changes” to a pension
11 system to permit its efficient functioning, but such changes “should be
12 accompanied by comparable new advantages” for affected beneficiaries. *Betts*, 21
13 Cal.3d at 864. Here, the County cannot show that the elimination of the Subsidy
14 was a “reasonable change” to the Retiree Medical Program, and the County cannot
15 contend that it offset that change with “comparable new advantages” for retirees.

16 CONCLUSION

17 As the Washington Supreme Court recently found, when a public entity
18 provides an employee with a retiree health benefit and, consequently, obtains that
19 employee’s service and labor, the public entity is not free to deny or revoke retiree
20 health benefits after the employee retires. *Navlet*, 194 P.3d at 237. “The
21 compensatory nature of the benefits creates a vested right in the retirees.” *Id.* at
22 233.

23 The undisputed facts show that Orange County:

- 24 • provided the Subsidy for 22 years;
- 25 • repeatedly characterized the Subsidy as a retirement medical benefit
26 that the County would continue to provide;
- 27 • considered the Subsidy to be a material term of its collective
28 bargaining agreements with employee unions; and

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