G. SCOTT EMBLIDGE, State Bar No. 121613
RACHEL J. SATER, State Bar No. 147976
MICHAEL P. BROWN, State Bar No. 183609
MOSCONE, EMBLIDGE, & QUADRA, LLP
220 Montgomery Street, Suite 2100
San Francisco, California 94104-4238
Telephone: (415) 362-3599
Facsimile: (415) 362-2006

Attorneys for Retired Employees Association of Orange County, Inc.

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

RETIRED EMPLOYEES ASSOCIATION OF ORANGE COUNTY, INC.,

Plaintiff,

vs.

COUNTY OF ORANGE,

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

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

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

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

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

There is no dispute over the facts material to plaintiff Retired Employees Association of Orange County's ("REAOC's") claims:

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

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

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

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

STATEMENT OF FACTS

I. THE RELEVANT LABOR AGREEMENTS

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

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

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

II. THE SUBSIDY WAS A LONDSTANDING, CONSISTENT, WELL-ESTABLISHED AND RECOGNIZED RETIREE MEDICAL BENEFIT

A. The Establishment Of The Subsidy (1985)

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

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

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

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

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

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

The cost of the Subsidy resulted in the higher health insurance premiums charged for active County employees. Harris Decl., ¶ 6. Throughout the Relevant Period, the County paid most of the cost of the Subsidy (because it paid most of active employee premiums). Harris Decl., ¶ 6.[1]

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

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

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

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

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

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

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

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

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

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

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

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

Likewise, the Orange County Employees Retirement System ("OCERS") 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

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

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

1. The Negotiations Leading To The 1993 Grant Program

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

[2] The County and OCERS also discussed the Pooled Rate Structure and the Subsidy in relation to their 2001 settlement of claims relating to the County's 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.

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

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

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

[3] The County used the term "Hidden Subsidy" because the Subsidy was contained within the active employee premium rates, rather than being paid directly to retirees. Carlaw Decl., ¶ 12. The "tax advantage" assumed that the grant and Subsidy benefits would not be taxed, and assumed an average income tax 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.

- In an April 27, 1992 presentation, under the heading "Health Rate Structure," the County stated that under the new grant plan (as previously) "retiree rates *will continue to be pooled* for rate setting purposes." Carlaw Decl., ¶ 14, Exh. D. (emphasis added). Negotiation notes from that session also include the following: "Health Rate Structure – Pool – Continue." *Id.*, Exh. E. A slightly different version of that April 1992 presentation stated, under "Health Rate Structure," that "retiree rates will equal employee rates." *Id.*, Exh. X.

The County's purpose in explaining and quantifying the Subsidy, characterizing it as an employment benefit, and assuring the Unions that it would continue to provide it, was not simply to demonstrate its beneficence. Rather, the County sought to convince the Unions to agree to the *County's* proposed terms for the 1993 Grant Program. Patton Decl., ¶ 16; Carlaw Decl., ¶ 10; Harris Decl., ¶ 14. The County badly wanted to secure a deal with the Unions to establish the new grant program, because as part of that deal OCERS would allow the County to access some $150 million in a $200 million in a retirement investment account that OCERS controlled. Patton Decl., ¶ 16.[5] But the County did not want to spend its own money to fund the new benefits. Rather, it proposed to fund the grant program using only money from (1) a surplus OCERS account and (2) active employees' ongoing monthly contribution of 1% of their wages. Patton Decl., ¶ 17; Carlaw Decl., ¶ 11; Harris Decl., ¶ 15. The Unions, for their part, wanted the County to put up a substantial sum of *County* money to pay for the contemplated

[5] There was an ongoing dispute at the time among the County, OCERS and the Unions over who was entitled to these surplus funds. The County contended that the funds belonged to it, while the Unions argued that it belonged to the employees. The parties ultimately agreed that OCERS would set aside $50 million to fund future Grant benefits and allow the County to have the remaining $150 million. Patton Decl., ¶ 18. In addition to wanting to secure that $150 million, the County wanted to reach a deal to placate the Unions generally regarding retiree medical benefits and also to settle the litigation with OCEA over that issue. Patton Decl., ¶ 18; Harris Decl., ¶ 14.

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

2. The Agreed Terms Of The 1993 Grant Program

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

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

[6] From 1966 through 1978, retirees received a monthly grant to cover or defray the costs of insurance (the "1966 Grant Benefit"). Harris Decl., ¶ 19. The 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)

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

3. The Subsidy And The Grant As Linked Benefits

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

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

[8] The terms of the 1993 Plan Document were not negotiated or agreed 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.

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

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

1. The Annual Mercer Reports (1993 – 2007)

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

2. The 1998 Actuarial Report

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

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

3. The 2005 GASB Report

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

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

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

service/paid after retirement" benefits, and estimated the 30-year projected cost of providing that benefit. *Id.*[11]

E. The County's Negotiations With The Unions To Remove The Subsidy From Active Employees (2005-2006)

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

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

[11] In other documents discussing the impact of GASB 45—including reports to the Board of Supervisors—the County referred to the Subsidy as a "benefit[] being earned in the current year" (that is, as the employee performs service for the County), even though the benefit was not paid until retirement. 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

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

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

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express term because it recognized that the Pooled Rate Structure was an established policy and practice, and as such was an implied MOU term. *Id.*

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

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

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

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

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

III. THE COUNTY'S UNILATERAL ELIMINATION OF THE SUBSIDY FROM RETIREES (2008)

By the end of 2006 the County had secured deals with the Unions to trade large wage increases in exchange for the Unions' agreement to surrender the Subsidy for their current active employee members, effective January 1, 2008. All parties agreed that the issue of current retirees' rights to health benefits was *not* a subject of those negotiations. Crost Decl., ¶ 3. Having made those deals with active employees, the County *unilaterally* removed the Subsidy from retirees, believing that, unlike active (represented) employees, retirees had *no rights* with respect to retiree medical benefits, other than to be informed after the fact of the County's unilateral decision. Indeed, in its public deliberations over the question 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

Unions regarding *active* employees' rights to future retirement health benefits. Brown Decl., ¶ 28, Exh. AA at 52-54.

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

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

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

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

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

ARGUMENT

I. THE COUNTY'S UNILATERAL REMOVAL OF THE SUBSIDY VIOLATED THE CONTRACTS CLAUSES OF THE FEDERAL AND CALIFORNIA CONSTITUTIONS.

Article I, section 10 of the United States Constitution forbids a state or political subdivision thereof, such as the County, to pass "any . . . Law impairing 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

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

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

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

II. COUNTY RETIREES HAD A CONTRACTUAL RIGHT TO THE SUBSIDY.

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

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

A. Retirement Health Benefits Are A Component Of Compensation

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

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

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

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

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

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

[15] In reaching its conclusion, the *Thorning* court noted the "fundamental" nature of retirement health benefits—the fact that they were provided as part of an 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.

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

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

[16] The *Kistler* court noted the distinction between private and public sector employment, but adopted the *Suastez* reasoning because (1) the *Suastez* Court had "employed general principles of law" in determining that accrued vacation pay 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.

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

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

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

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

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

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

[17] *See Jensen*, 38 F.3d at 951 (employer's "policy of not changing the benefits of prior retirees" is "consistent with the concept of vested benefits"); *Angotti*, 2006 WL 1646135 at *10 (N.D. Cal. 2006) ("Rexam's conduct prior to this dispute, which never involved a significant termination or reduction in 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.").

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

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

A. The Subsidy Was A Recognized Retirement Health Benefit.

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

Finally, from 2005 through 2007, as the County was preparing to eliminate the Subsidy, it repeatedly classified it as a "benefit" and an "Other Post Employment Benefit."[19]

[19] The parties' treatment of the Subsidy as an employment benefit is in accord with judicial decisions in other, related contexts. *See, e.g., Erie County 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

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- Mr. Beckett—the County's public finance manager and a architect of the restructuring of the Retiree Medical Program, testified that prior to the restructuring the Subsidy was indeed a "benefit" provided under the Retiree Medical Program. Beckett Depo., 20::5-21:2.
- The County's 2006 Request for Proposal for litigation counsel, to provide advice relating to restructuring of the Retiree Medical Program, states that the County "currently offers the following *post-employment benefits*: (1) County of Orange Retiree Medical Plan . . . [and] 2. Health Insurance Rate Pooling." Brown Decl., ¶ 36, Exh. II (emphasis added). Under "Health Insurance Rate Pooling," the County describes the Subsidy as follows:

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

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

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

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

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coverage and other benefits which a retired person receives from his or her former employer").

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

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

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

[20] Employees' right to receive the Subsidy upon retirement would be eliminated and their Grant Benefits substantially reduced.

service for the County), even though the benefit was not paid until retirement. Brown Decl., Exh. R.[21]

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

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

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

[21] Mercer and the County had prepared a fiscal year 2004 actuarial report that did not specifically address the GASB 45 requirements. However, it did explain that "the value of the subsidy provided to retirees by extending medical benefits to retirees at the same rate charged to active employees" was "[i]ncluded 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.

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

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

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

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

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

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

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

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

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

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

[22] A long line of United States Supreme Court precedents supports this doctrine. *Consolidated Rail Corporation v. Railway Labor Executives' Assn*, 491 U.S. 299, 311-12 (1989) ("Neither party relies on any express provision of the agreement; indeed, the agreement is not part of the record before us . . . however, collective-bargaining agreements may include implied, as well as express, terms . . . A collective bargaining agreement is not an ordinary contract for the purchase of goods and services . . . it is a generalized code to govern a myriad of cases which the draftsmen cannot wholly anticipate . . . [i]n this case, Conrail's contractual claim rests solely upon implied contractual terms, as interpreted in light of past practice. *See also Detroit & Toledo Shore Line R. Co. v. United Transportation Union*, 396 U.S. 142, 155 (1969) ("Where a condition is 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.

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

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

1. The Health Plan Booklets

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

[24] Other circuits are in accord. *See, e.g.*, *Yashon v. Gregory*, 737 F.2d 547, 553-54 (6th Cir. 1984) (under *Sindermann*, "an employee may still have a property interest in continued employment if an agreement between the employer and the employee can be implied or if the unwritten 'common law' of the work place 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).

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

2. Past Practice and Course of Dealing

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

[25] The reference to Medicare "adjustment" pertained to the County's practice of providing a discount for Medicare-enrolled participants, over and above the discount inherent in their pooled rates. Harris Decl., ¶ 20.

[26] In the same booklet the County provided that *active* employees on unpaid leave of absence had to pay the "full cost of the health insurance premium" to remain covered under their County plan. The terms "full premium," "full 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.

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

a. Longstanding, Established and Recognized

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

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

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

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

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

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

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

b. Significant

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

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

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

c. Negotiable

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

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

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

[29] The County acknowledged the "significance" of the Subsidy when it recognized that the MMBA required it to bargain with the Unions in order to eliminate it from active employees' benefits package. *Claremont Police Officers 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.

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

Ms. Carlucci was personally involved in the negotiations with the Orange County Managers Association regarding changes to the Retiree Medical Program. *Id*., 93:22-98:1. She testified that "one of the changes [she] negotiated to the MOU" between the County and that union "was the splitting of the pool." Carlucci Depo. at 96:13-23; 97:8-98:1. Paul Crost, one of the chief negotiators for OCMA during those discussions, similarly recalls that the County treated the Subsidy as a term in the existing MOU that had to be amended to reflect the splitting of the pool. Crost Decl., ¶ 9.[31]

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

[30] When Ms. Carlucci's referred to the "program," she was including the Subsidy and the 1993 Grant Benefits. *Id.* at 56:13-57:1; 148:5-23.

[31] Ms. Carlucci was also personally involved in the County's negotiations with another union—the Eligibility Workers Unit—over these changes. She 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)

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

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

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

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

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

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

The parties' course of dealing, the County's express promises in the Health Plan Booklets, and the County's admissions all establish that the MOUs contained an implied promise on the part of the County: to permit employees, upon retirement, to participate in the same County health plans as active employees and pay the same premiums as active employees. That implied promise must be treated as if it were an *express* promise; County Retirees' rights to that benefit deserve the same protection as rights that arise from express MOU terms. *Bonnell/Tredegar,* 46 F.3d at 346 (terms derived from past practice are "as binding and enforceable as an express terms of the [collective bargaining] agreement"); *Youngman*, 70 Cal.2d at 246 (finding in the context of *public sector* collective bargaining agreements—that "the only significant difference" between implied and express contracts "is the evidentiary method by which proof of their existence and terms is established." *See also Foley v. Interactive Data Corp*., 47 Cal.3d 654, 677-78 (1988) (implied in fact contracts generally "stand on equal footing" with express contracts), *quoting* Restatement 2nd of Contracts, § 19 ("there is no distinction in the effect of the promise whether it is expressed in writing, or orally, or in acts, or partly in one of these ways and partly in others.").

D. The County Did Not Reserve The Right To Eliminate The Subsidy.

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

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

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

III. THE COUNTY SUBSTANTIALLY INTERFERED WITH RETIREES' RIGHTS TO THE SUBSIDY.

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

IV. THE COUNTY CANNOT ESTABLISH THAT ITS INTERFERENCE WAS LAWFUL.

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

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

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

CONCLUSION

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

The undisputed facts show that Orange County:

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

- acknowledged repeatedly that the Subsidy was an element of its employees' compensation.

Given these undisputed facts and well established law, the Court must find that Orange County's revocation of the Subsidy violated the contract clauses of the federal and state constitutions, and must grant Plaintiff's motion for summary adjudication of its fifth and sixth claims.

Dated: November 20, 2008

Respectfully Submitted,

MOSCONE, EMBLIDGE & QUADRA, LLP

By: /s/
G. Scott Emblidge

Attorneys for Plaintiff