SUPREME COURT OF THE STATE OF CALIFORNIA
No. S184059

RETIRED EMPLOYEES ASSOCIATION OF ORANGE COUNTY,
Petitioner,

vs.

COUNTY OF ORANGE,
Respondent.

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

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PETITIONER'S OPENING BRIEF ON THE MERITS

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ISSUE PRESENTED FOR REVIEW

The United States Court of Appeal for the Ninth Circuit certified the following question of California law to this Court:

> Whether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees.

INTRODUCTION

For 23 years, one of the elements of compensation the County of Orange ("the County") provided to its employees was the right to remain enrolled in the County-sponsored health plans after retirement, with the County (and active employees) substantially subsidizing the premiums retirees paid to remain enrolled in those plans. This benefit—the Retiree Premium Subsidy—represented a substantial sum of money for County retirees. By the County's own estimates, by 2007 the Retiree Premium Subsidy had an average cash value of more than $3,000 per year, per retiree. That amount is significant by any measure, but it was especially important to a population that lives on fixed pension incomes that averaged less than $30,000 per year in 2008.

In 2006, the County embarked on an effort to "restructure" its retiree medical benefits program. As part of that effort the County decided to eliminate the Retiree Premium Subsidy. It bargained with its employee unions to get their agreement to surrender active employees' future rights to receive the Retiree Premium Subsidy upon their retirement. The unions agreed to give up this critical benefit, and in exchange received significant increases in immediate wage compensation.

However, *retired* County employees were not part of these labor negotiations, because they were not represented by the unions. The County considered the option of making its elimination of the Retiree Premium Subsidy "prospective" only, that is, continuing to provide that promised benefit to those employees who had already retired as of the date of the medical benefits restructuring (January 1, 2008). Had the County taken this reasonable approach, the cost of providing the Retiree Premium Subsidy would have been modest (less than $1 *million* per year for a county with a $3.5 *billion* annual budget) and would have inevitably dwindled every year, as the closed pool of pre-2008 retirees moved into Medicare eligibility and shrank due to mortality. However, the County instead decided unilaterally to revoke this critical benefit from all 6,000 retirees (and their dependents) who relied on it to maintain medical insurance coverage.

The damage inflicted on County retirees has been severe. The Retiree Premium Subsidy was designed to, and for 23 years did, reduce insurance premium inflation for the older participants in the County-sponsored health plans, especially those thousands of retirees who were not eligible for Medicare and therefore depended on County-sponsored plans as their sole or primary medical insurance. For example, during the final four years that the premium subsidy was in effect (2004 through 2007), premiums for non-

Medicare retirees increased by roughly 5% per year in the County's self-funded health plans. By contrast, during the four years since the County stopped subsidizing retiree premiums in 2008, premium inflation for non-Medicare retirees in those plans has *tripled*, to 16% per year on average. Indeed, the County recently announced that 2011 premium increases for retirees in both self-funded plans will be 24.6% higher than 2010 rates. At this rate, premiums will nearly double every three years.

Retirees' pension incomes are modest (less than $30,000 per year on average), and are subject to a maximum annual "COLA" increase of less than 3% per year. Accordingly, the drastic increase in the rate of medical insurance premium inflation is causing retirees' premiums to devour their pension income at an alarming rate. In 2007, the $14,000 annual premium for a retiree with one dependent enrolled in the Wellwise Plan represented approximately 50% of the average annual pension income of a County retiree. But in 2011, the $25,000 annual premium for the same retiree in the same plan will represent approximately *90%* of that income. If this trend continues, premiums for non-Medicare retires in this plan will *surpass* total retiree pension income by 2013.

But the financial statistics tell only part of the story. To cope with the extra expense of unsubsidized premiums, retirees forego other necessities, deplete their savings, shift into "catastrophic" health plans that offer lower premiums but much higher deductibles and copayments, and/or drop coverage entirely.

The County's legal justification for this draconian decision was this: despite the fact that for 23 years the Retiree Premium Subsidy had been treated by *all* parties as a critical component of the County's retiree medical benefits program, and an element of deferred compensation offered to attract and retain the County's workforce, the benefit had never been reduced to an express written "promise" in County legislation. Thus, the County argued, it was "off the hook" when it came to any legal obligation to continue to provide this benefit to the retired workers who had earned it.

This cynical excuse—that they "never put it in writing"—would obviously not fly in the context of private sector employment agreements. It is well-settled that an employer's policies and practices give rise to implied-in-fact contract rights and duties for employees and employers alike. (*See Scott v. Pacific Gas & Electric Co.* (1995) 11 Cal.4th 454, 463.) But the County insists that it is immune from contractual duties because it is a governmental agency. As such, the County contends, as a matter of law it cannot be bound by implied-in-fact contract terms. However, the County's *per se* immunity argument is plainly contrary to the Civil Code and the precedents of this Court, the Court of Appeals, and the Public Employee Relations Board ("PERB"), all of which require that public contracts be construed in like manner as private contracts, and more specifically that public employers may indeed be bound to implied-in-fact employment terms that arise from established policies, practices and courses of dealing. (*See* Argument Section I below.)

This Court need not choose between the interests of public agencies, in retaining reasonable control over their liabilities, and those of public employees and retirees, in receiving the compensation promised them in exchange for their work. Both interests are legitimate and both are fairly balanced under current legal principles, which require that past practices be well established and recognized before they become implied-in-fact contract terms, and that public entities not be bound by financial obligations of which policy-making officials–and the public–were unaware. (*See id.*)

Here, the County Board of Supervisors established the Retiree Premium Subsidy and knowingly reenacted it every year for 23 years each time the Board set premium rates. In addition, the Board (and the public) knew the costs associated with this post-employment benefit because it received annual reports explaining the Retiree Premium Subsidy, characterizing it as a historic County "policy" and "practice," and quantifying its projected cost. Finally, the Board knew its employees viewed the subsidy as an element of compensation, because the County repeatedly used it as a bargaining chip in labor negotiations with its active employees.

In short, the Board of Supervisors was well aware of the commitment it repeatedly made to its employees that—as part of their compensation package—they would be entitled to subsidized health benefits once they retired. There is no legal or public policy reason to excuse the County from living up to its commitment to its retirees.

PROCEDURAL BACKGROUND

REAOC filed this lawsuit in November 2007 in the United States District Court for the Central District of California, seeking a declaration that the County's confiscation of this retirement benefit violates the contracts clauses of the federal and California Constitutions. In December 2008, REAOC and the County argued cross-motions for summary judgment. Six months later, in June 2009, the District Court granted the County's motion and denied REAOC's, holding that settled California law *per se* prohibits any implied contract terms relating to compensation in public employment.

REAOC appealed to the United States Court of Appeals for the Ninth Circuit, and requested an expedited appeal schedule. The Ninth Circuit found good cause for expediting the appeal and, over the County's objection, granted REAOC's request. It heard argument on June 10, 2010.

At the oral argument, the panel concluded—contrary to the District Court's holding—that California law was unclear on the question of whether binding implied terms relating to compensation (such as retirement benefits) may arise in public employment. The panel therefore asked that this Court accept certification of the following question: "Whether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees."

REAOC submitted a letter requesting that this Court accept certification, but re-formulate the question to make it clear that it is best understood as presenting two questions: (1) whether California law recognizes implied-in-fact contract terms, relating to retirement health benefits, in public sector employment; and (2) whether benefits conferred by such terms are "vested" *in the sense* that they cannot be unilaterally revoked, without compensation, *from existing retirees*. REAOC wanted to clarify that it does not assert that the Retiree Premium Subsidy was "vested" as to active employees, and that this litigation does not challenge the County's right to *negotiate* with those active employees to persuade them to surrender their right to receive it in the future—upon their retirement—in exchange for wage increases or other offsetting compensation.

This Court accepted certification by Order dated August 18, 2010. The Court appears to have accepted the question as originally phrased by the Ninth Circuit.

STATEMENT OF FACTS

It would be a simple matter for this Court to correct the District Court's error by clarifying that there is no *per se* prohibition under California law against implied-in-fact contract obligations and rights arising in public employment. However, REAOC believes that the resolution of this litigation will be facilitated if this Court goes further, to provide guidance regarding the sorts of factual circumstances under which a "past practice" or "course of dealing" ripens into a binding contractual obligation on the part of a public employer and/or employee. To assist the Court in this task (if it chooses to undertake it), REAOC sets forth below the factual account of the 23-year practice and course of dealing between the County and its employees regarding the premium subsidy at issue in this case.[1] That record reflects an almost entirely undisputed 23-year history of the County (1) promising this retirement benefit to its employees and providing it to its retirees, and (2) characterizing this benefit as an element of the *compensation* package the County used to attract and retain a skilled workforce to carry out its business. REAOC will refer to this span of 23 years as the "Relevant Period."

I. THE COUNTY INSTITUTED THE SUBSIDY IN 1985.

For 41 years, from 1966 through 2007, the County provided its retired employees the opportunity to participate in the same County-sponsored health insurance plans as active employees. (ER II: 153:18-23; ER III: 326:1-2; ER III: 359-360.) During the first 18 of those years, from 1966 through 1984, the County attempted to track the insurance claims of active and retired employees separately, and to use that claims data to set premiums separately for each group. (ER II: 153:24-154:4; ER V: 914:26-915:7.) But in 1984 the County discovered that it had been tracking active and retired employee claims expenses incorrectly. (*Id.*) The mistake had resulted in

[1] In its Order granting summary judgment in favor of the County and denying REAOC's cross-motion, the District Court's Order examined almost none of the factual record developed in this case, holding that the only salient fact was the absence of an express written promise on the part of the County's board of supervisors to continue to provide the retiree premium subsidy to County retirees. (ER I: 6:14-22.)

retiree claims being significantly under-reported and active employee claims being over-reported. (ER V: 915:1-7; ER II: 153:24-154:4.) That faulty claims reporting also meant that retirees as a group were paying premiums that were falling far short of covering their claims expenses. (*Id.*)

To bring retiree premiums in line with retiree claims expenses, the County would have had to increase retirees' premiums by 112% for 1985. (ER V: 915:8-16; ER II: 154:5-18.) The County determined that such an increase was too drastic, and that retiree premiums would be subject to excessive inflation over time if they were in fact rated and charged as a separate group of participants. For these reasons, the County opted to formally equalize active and retiree premiums, by combining all beneficiaries into one "pool" for purposes of premium rate-setting. (ER V: 915:8-23; ER II: 154:5-18; ER III: 326:3-6; ER III: 365-377.) REAOC will refer to this as the "Pooled Rate Structure."

The County understood that, as a group, retired employees were on average older, and therefore more expensive to insure, than active employees. (ER V: 913:20-28; ER III: 326:7-8; ER III: 380:10-381:3; ER III: 325:26-27; ER III: 333-334.) Accordingly, under the Pooled Rate Structure, active employees' premiums subsidized retirees' premiums—active employee premiums were higher, and retiree premiums lower, than they would have been if the County had tracked each group's claims separately and set separate premiums according to their respective claims experience. (ER V: 913:20-28; ER III: 333-335; ER III: 382:2-383:6.) The County and its employee unions referred to this subsidization variously as the "implied subsidy," the "implicit subsidy," and the "retiree premium subsidy." REAOC will refer to it here as "the Retiree Premium Subsidy."

During the Relevant Period the County covered most of the cost of active employees' health premiums; active employees paid "out of pocket" for a share of those premiums. Thus the cost of the Retiree Premium Subsidy was borne mostly by the County and, to some extent, by active employees. (ER V: 914:3-14.)

II. Soon After It Was Instituted, The RETIREE PREMIUM Subsidy Became A Well-Established And Recognized Practice And A Subject Of Collective Bargaining.

From the beginning of the Relevant Period, the County, the unions, and County retirees 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 Retiree Premium Subsidy (1) within the Human Resources Department, (2) with the County's retained employee benefits consultants (Mercer, Inc.), and (3) with the

Board of Supervisors and Board staff. (ER II: 154:19-28; ER II: 185:15-25; ER V: 915:24-917:14; ER III: 362:15-25.) In numerous bargaining sessions with the unions during that period, the County characterized the Retiree Premium Subsidy as a valuable benefit that it provided to employees and retirees. (ER II: 155:10-15; ER II: 185:26-186:4; ER V: 915:24-917:14.)

From 1986 through 1990 the County and the unions engaged in litigation over the unions' demand that the County pay the *entire* cost of retiree medical insurance premiums, on the same terms as it paid for active employees' premiums. (*See Orange County Employees Association v. County of Orange* (1991) 234 Cal.App.3d 833) ["*OCEA*"].) In its 1991 published opinion, the California Court of Appeal described the County's Pooled Rate Structure, and the Retiree Premium Subsidy that resulted from it, as an element of the *comprehensive plan* available to active employees and retirees:

> Each [health plan] option provided retirees and employees with exactly the same benefits, *at the same premium cost* . . . 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*.

(*OCEA*, 234 Cal.App.3d at 837-38 [emphasis added].[2])

In 1990 the County's employee benefits department prepared a six-page "Rate Proposal" document to assist the Board of Supervisors in its approval of premium rates for County-sponsored plans. (ER V: 915:24-917:14; ER V: 923-945; ER III: 329:17-19; ER IV: 871-879.) The Rate Proposal discussed the Pooled Rate Structure and the Retiree Premium 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 . . .*

(ER V: 931 [emphasis added].) The document quantified the projected amount of the Retiree Premium 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.*) The County went on to

[2] The appeal in *OCEA* did not present any issues relating to retirees' contractual rights to additional retirement health benefits. Rather, the sole issue was whether a particular statute, Government Code section 53205.2, required the County to provide the exact same health benefits to active and retired employees. The court held, correctly, that the statute only imposed the requirement that counties "prefer" health plans that offer equal benefits; it did not mandate that they choose such plans. (*Id.* at 841-43.) Here, REAOC is making no claim under section 53205.2 or any other statute, so while the court's description of the County's retiree health benefits program is relevant to this dispute, its holding is not.

prepare similar Rate Proposals for the Board's review *every year* from 1993 through 2007. (ER III: 473, 479, 487, 493, 499, 505, 511, 517, 524, 531, 537, 544, 549.) Every one of those 15 reports—all of which were reviewed and adopted by the Board—repeated the explanation of the Retiree Premium Subsidy, characterized it as a historic County "policy" and "practice," and quantified its projected cost. (ER III: 327:14-16; ER III: 476, 482, 490, 496, 502, 508, 514, 521, 528, 535, 541, 548, 553.)

From 1991 through 1993 the County and the unions bargained extensively over the subject of adding another retirement health benefit to the existing "package" of benefits. (ER II: 185:26-187:11.) This new benefit was to be a monthly stipend—called the Retiree Medical Grant (the "Grant")—which the County would provide to retirees to defray the cost of their (already subsidized) monthly premium. (ER II: 186:5-15, 187:1-11.) During those negotiations, the County made repeated and express reference to the Retiree Premium Subsidy as a valuable existing retiree medical benefit, and as part of the proposed new "package" of retirement health benefits that employees would enjoy upon retirement. (ER II: 186:1-4.) The County even quantified the cash-value of the Retiree Premium Subsidy to each employee/retiree to be approximately $270 per month. (ER II: 187:25-188:15-22, 196, 209.)

The County had a keen financial interest in impressing upon the unions the "value" of the Retiree Premium Subsidy. It needed the unions' approval before it could access some $150 million in a reserve account controlled by the Orange County retirement board. But the unions disputed the County's entitlement to that money. (ER II: 157:11-158:24.) The County presented the proposed "improved" retirement benefits package—the institution of a new benefit and the continuation of the existing subsidy—as an inducement to the unions to provide their consent. (ER II: 187:1-24; ER V: 918:8-26.) The County did obtain the unions' assent to the proposed deal—employees and retirees got a new benefit *and* express assurances that the old benefit (the Retiree Premium Subsidy) would continue (*See* ER III: 327:6-8 [County's negotiation notes from 1991 bargaining session state that "*uniform rates* for actives and early retirees *will continue*"]; ER III: 436 [from 1992 bargaining session notes: "Questions for response from [the union] . . . Will we *continue to commingle benefits*? Answer – *Yes*."]; ER II: 188:23-189:8; ER II: 255 [1992 bargaining notes state that "*retiree rates will continue to be pooled* for rate setting purposes"] [emphasis added].) In exchange, the County got its $150 million. (ER V: 187:21-22.)

III. THROUGHOUT THE RELEVANT PERIOD THE COUNTY AND THE UNIONS RECOGNIZED THAT THE RETIREE PREMIUM SUBSIDY WAS AN IMPLIED TERM AND A CONTRACTUAL PROMISE.

The written collective bargaining agreements between the County and the unions are called "Memoranda of Understanding" ("MOUs"). The MOUs in effect during the Relevant Period included express terms relating to employees' right to continue to be covered under County-sponsored health plans during their retirement. (ER IV: 874.) Documents called "Health Plan Booklets" that the County distributed to its employees also explained that employees would be entitled to continue to participate in the County's health plans during their retirement, as long as they were receiving a pension check. (ER V: 920:26-921:15; ER V: 978.) But those express provisions did not establish what premiums would be required to maintain that retirement coverage, or how such premiums would be calculated. (ER IV: 874.)

The parties did, however, treat the Retiree Premium Subsidy as an *implied* term in their agreements. (ER II: 158:25-159:6.) Indeed, the subsidy's status as an implied contract term was underscored when the County sought, in 2005 and 2006, to use the collective bargaining process to eliminate that benefit from current employees' post-employment benefits package.

Prior to that bargaining process, the County acknowledged that it could not unilaterally eliminate the Retiree Premium Subsidy (as a future benefit) from current employees, because that benefit was a "term or condition of employment" under the MMBA; terms or conditions of employment may be altered only through the collective bargaining process. (ER III: 328:8-10; ER III: 345:24-346:9; ER IV: 663, 665, 673-675.) The County's Person Most Knowledgeable about those negotiations testified that changes to the "program" of retirement health benefits—the Retiree Premium Subsidy and the Grant benefits—had to be negotiated because "[t]he program *was in our MOU. We were making changes with the MOU*. . . ." (ER III: 354:16-355:6 [emphasis added].)

During the collective bargaining process that ensued, the County repeatedly and explicitly characterized its proposed elimination of the Retiree Premium Subsidy from active employees as a "*new term*" or a "*changed term*" from the existing MOUs between the County and each respective union. (ER III: 391:20-393:2; ER III: 352:13-353:23, 350:8-351:1.)

After the bargaining process concluded, the County and the unions entered into amended MOUs to reflect the elimination of the Retiree Premium Subsidy. In the "replacement" MOUs the County flagged the new "split pool" provisions to highlight (for the Board's review) the *change* from the terms of the prior MOUs. (ER III: 328:4-7, 11-13; ER III: 692; ER III: 654; ER III: 338:22-339:1, 340:7-341:11, 350:8-351:1, 352:13-353:23.) Confirming the meaning of these references to "changed" MOU terms, Ms. Carlucci testified that "the splitting of the pool" was "one of the *changes* we negotiated *to the MOU* . . ." (ER III: 353:13-23; 350:8-351:1 [emphasis added]).

Even as the Board of Supervisors was voting to "split" the premium pool, it acknowledged that it had a contractual obligation to continue to provide the Retiree Premium Subsidy to *current retirees*. For example, at an April 2005 Board meeting, Supervisor Chris Norby characterized the subsidy as a "*legally binding contractual commitment*" between the Board and its retired employees, and stated that those commitments "*certainly do . . . have to be met*." (ER IV: 749-750 [emphasis added].) No one on the Board took issue with Supervisor Norby's characterization, although he and the entire Board would later vote to breach that "legally binding contractual commitment" to then-current retirees. (*Id.*)

IV. THE COUNTY AND THE UNIONS TREATED THE RETIREE PREMIUM SUBSIDY AS A POST-EMPLOYMENT BENEFIT AND AN ELEMENT OF DEFERRED COMPENSATION.

Faced with REAOC's legal challenge, the County embarked on an Orwellian effort to re-write the 23-year history of the Retiree Premium Subsidy, to erase its obligation to provide that promised benefit to those who had already retired. As the County is well aware, it is long-settled law that (1) post-employment health benefits are elements of employee *compensation*, and (2) public employees are contractually entitled to receive compensation once it has been earned. (*Olson v. Cory* (1980) 27 Cal.3d 532, 535-36. Faced with this established law, the County was forced to argue that the Retiree Premium Subsidy was never a post-employment "benefit" or an element of employee compensation at all, but instead was a mere "gratuity"—just something nice that the Board was "pleased to offer" its retirees, every year for 23 years. As set forth below, the County's about-face is untenable in light of the undisputed factual record.

A. In Its Financial And Actuarial Reports, The County Characterized The Retiree Premium Subsidy As A Post Employment Benefit And An Element Of Compensation.

In addition to the annual Rate Proposal documents that described and quantified the value of the Retiree Premium Subsidy for a given year, during the Relevant Period the County prepared several "actuarial" reports that defined the subsidy as a retirement medical benefit, and projected the cost of that benefit for future years.

For example, a 1998 report described the Retiree Premium Subsidy as a "Retiree Medical Benefit" no fewer than *seven* times. (ER III: 327:9-22; ER III: 583-588.) It treated the Retiree Premium Subsidy as a "benefit earned based on service rendered." (ER III: 592.) It explained that "[a]ctive employees subsidize retiree medical plan" and that in 1998 "retiree premiums would be 58% higher without subsidy." (ER III: 583.) The report quantified the amount of the Retiree Premium Subsidy for an individual 62 year-old retiree in 1997 ($329 per month), 1998 ($354 per month) and 1999 ($378 per month). (ER III: 584.)

In 2005, the County prepared another actuarial report in response to a new rule issued by the Government Accounting Standards Board ("GASB"), called "GASB 45." GASB 45 required government agencies to determine which of their obligations to active and retired employees qualified as "other [than pension] post employment benefits," or "OPEB." (ER III: 327:17-18; ER III: 571.) As the County's own report explained, GASB defined OPEB as post-employment *benefits* that the agency is *obligated* to pay. (ER III: 328:1-3; ER IV: 623, 631, 632, 648.) Under GASB, OPEB are benefits that employees "earned" during their active employment—as part of their total compensation—even though the benefit is not “paid” to the employees until after they retire. (ER IV: 648.) The County determined that the Retiree Premium Subsidy was a benefit that was earned before it was paid, and therefore fit that GASB definition. (ER III: 386:19-387:8, 388:18-389:18, 390:3-391:14; ER IV: 627, 629, 632.)

In 2007, the County’s “Public Annual Financial Report” (“PAFR”) referred to the Retiree Premium Subsidy as a post-employment benefit, and clearly underscored the compensatory nature of that benefit. (ER VI: 1233.) The PAFR explained that, “[i]n addition to supporting a secure retirement for our employees, these *benefits* [the Retiree Premium Subsidy and the grant benefit] constitute *an important component of the total compensation package* the County offers *to attract and retain the skilled workforce* . . .” (*Id.* [emphasis added].) It explained that by eliminating the Retiree Premium Subsidy the County had “significantly altered post-employment health care benefits.” (ER VI: 1226.)

B. When It Sought Federal And State Funding, The County Characterized The Retiree Premium Subsidy As A Post-Employment Benefit And An Element Of Compensation.

Throughout the Relevant Period the County characterized the Retiree Premium Subsidy as an employment benefit and element of compensation, for purposes of billing the Federal and State governments for partial reimbursement of the costs of providing that benefit. The County billed these costs under the general category "*Compensation* For Personnel Services," and the sub-category "Post-Retirement Health *Benefits*." (ER VIII: 1728:1-14, 1729-1731 [emphasis added].) To secure reimbursement the County further represented that the Retiree Premium Subsidy was "reasonable" compensation "*for the services rendered*" by the recipient of the benefit, and was provided pursuant to "an established policy" of the County. (ER VIII: 1729 [emphasis added].) Based on these representations, the County did in fact receive *many* millions of dollars in Federal and State program reimbursements for the cost of the Retiree Premium Subsidy. (ER VIII: 1722:15-22.) Had the County instead classified the Retiree Premium Subsidy as a mere "gratuity" it conferred on its retirees (the position it now takes in this litigation), it would *not* have qualified for this reimbursement of the cost of that benefit.[3] (ER VIII: 1725, 1729.)

[3] The County has given no indication that it intends to refund these millions of dollars to the federal and State governments, now that it has retroactively re-defined it as a gift rather than compensation.

C. When It Bargained With The Unions In 2005 And 2006, The County Characterized The Retiree Premium Subsidy As An Element Of Compensation.

As discussed above, in 2005 and 2006 the County negotiated with the unions to get their agreement to surrender the Retiree Premium Subsidy as a post-employment benefit for current employees, in exchange for an increase in immediate "cash" compensation. (*See*, *e.g.*, ER IV: 654.) During those negotiations, the County expressly characterized the Retiree Premium Subsidy as an element of employee compensation. Indeed, the County couched its proposal to the unions as a trade-off between elements of what it called employees' "*total compensation*" or "*global compensation*"—active employees (union members) would receive wage increases, in exchange for their agreement to surrender their existing rights to the future benefit of the Retiree Premium Subsidy. (ER II: 126:5-13; ER IV: 654; ER III: 328:4-7; ER III: 342:14-20, 343:25-344:14 [emphasis added].)

D. When It Sought Outside Counsel In 2006 To Defend This Litigation, The County Characterized The Retiree Premium Subsidy As A Post-Employment Benefit And An Element Of Compensation.

In 2006 the Board expected to face litigation from retired employees over its decision to eliminate the Retiree Premium Subsidy. It issued a "Request for Proposal" for outside counsel to provide services related to that expected lawsuit (the "RFP"). (ER III: 329:25-28; ER V: 901-911.) In the

RFP, County Counsel referred to the Retiree Premium Subsidy as a benefits "program," even though it was "not expressly included" in the MOUs, and explained that it was one of the "*post-employment benefits*" that the County "currently offers" its employees. (ER V: 903-905 [emphasis added].)

To summarize, prior to this litigation, the County's Human Resources managers, labor negotiators, program reimbursement staff, actuaries, accountants, benefits consultants and in-house counsel all characterized the Retiree Premium Subsidy in the same manner—as a post employment benefit and an element of employees' deferred compensation.

V. IN 2007 THE COUNTY UNILATERALLY ELIMINATED THE RETIREE PREMIUM SUBSIDY FROM RETIREES AND PROVIDED NOTHING IN RETURN.

After acknowledging that current employees had legally-protected rights to this retirement benefit, and negotiating with these employees to win their agreement to surrender it, the County concluded that current retirees had *no rights whatsoever* to receive the same benefit. In other words, the Retiree Premium Subsidy was a retirement benefit entitled to legal protection *only until* the day an employee retired and began receiving it; after that, the County could eliminate it at its pleasure.

Having reached this perverse conclusion, the County proceeded to eliminate the Retiree Premium Subsidy from its more than 5,000 retired employees, effective January 1, 2008. (ER II: 44:18-23; ER II: 69-74.) Using the County's own estimates, retiree premiums increased on average for all plans in 2008 by at least $1,908 per year. (ER V:1124:23-1125:4.) That represented a 41% increase over 2007 "pooled" rates. (*Id.*) For some plans, premiums nearly doubled. (ER V: 921:23-922:13; ER II: 120-121.) The *increase alone* represented more than 7% of the average total annual pension income ($26,736) for retired County employees in 2007. (ER III: 329:3-5; ER IV: 815.)

But the injury to retirees would get much worse in the ensuing years, as the premium inflation that the Pooled Rate Structure was designed to (and for 23 years did) keep in check began to ravage retirees' fixed and limited incomes. The retirees that have suffered most of the harm are those who are not eligible for Medicare and therefore depend on County-sponsored plans as their sole or primary medical insurance.[4] For example, during the final four years that the premium subsidy was in effect (2004 through 2007), premiums for non-Medicare retirees increased by roughly 5% per year in the County's self-funded insurance plans (the "Premier Wellwise" PPO Plan and

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[4] Most of these non-Medicare retirees are ineligible because they are not yet 65 years old (so-called "early retirees"). However, hundreds are ineligible because they worked during a time when the County did not participate in the Medicare program. This latter group will never be eligible for Medicare Part A, and will suffer the devastating effects of the elimination of the Retiree Premium Subsidy throughout their entire lives.

"Premier Sharewell" catastrophic, high-deductible plan). (Declaration Of Patricia Gilbert In Response To REAOC's Motion For Calendar Preference (filed September 15, 2010), ¶ 8.) By contrast, during the four years since the County stopped subsidizing retiree premiums in 2008, premium inflation for non-Medicare retirees in that plan has more than *tripled*, to 16% on average. (*See id.* at ¶ 20(a) and (b) (setting forth premium rates for Wellwise and Sharewell plans for 2011.) Indeed, the County recently announced that 2011 premiums for retirees in both self-funded plans will be a staggering 24.6%. (*See id.* at ¶ 20.). At this rate, premiums will nearly double every three years. As a result of the elimination of the Retiree Premium Subsidy, these non-Medicare retirees are bearing a massive and ever-growing financial burden, that for 23 years prior to 2008 was spread among *all* insurance plan participants (active and retired employees alike).

Retirees' pension incomes are modest to begin with (less than $30,000 per year on average), and are subject to a maximum annual "COLA" increase of less than 3% per year. (*See* ER III: 329:3-5; ER IV: 815.) Accordingly, the drastic increase in the rate of medical insurance premium inflation is causing retirees' premiums to devour their pension income at an alarming rate. In 2007, the $14,000 annual premium for a retiree with one dependent enrolled in the Wellwise Plan represented approximately 50% of the average annual pension income of a County retiree. But in 2011, the $25,000 annual premium for the same retiree in the same plan will represent approximately *90%* of that income. (*See* Gilbert Decl., ¶ 20(a).) If this trend continues, premiums for non-Medicare retires in this plan will *surpass* total retiree pension income by 2013. Retirees are literally being priced out of their only source of medical insurance coverage.

Of course, the financial statistics tell only part of the story. To cope with the extra expense of unsubsidized premiums, retirees forego other necessities, deplete their savings, shift into "catastrophic" health plans that offer lower premiums but much higher deductibles and copayments, and/or drop coverage entirely.

In 2006 Governor Schwarzenegger appointed the bipartisan California Public Employee Post-Employment Benefits Commission, to examine public employee benefits and the effects of GASB 45. (ER III: 329:6-9; ER IV: 816-833.) In its 2007 Report, the Commission noted the "drastic" nature of Orange County's decision to eliminate the Retiree Premium Subsidy from current retirees. (ER IV: 828-829.) 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." (ER IV: 823 [emphasis added].)

The Commission observed that, "[u]nlike many of the other agencies profiled in this report," Orange County addressed its retirement health benefit liabilities "by choosing to *drastically change the structure of its retiree health plan* to lower costs *rather than to fund previous obligations*." (ER IV: 829 [emphasis added].) The Commission prophetically noted that the County's decision will "greatly increase[] the premium for retirees," and that "*[t]he consequences for retirees . . .are likely to be both negative and significant*." (*Id.* [emphasis added]).

VI. THE COUNTY WOULD HAVE FACED NO DIFFICULTY IN CONTINUING TO FUND THE RETIREE PREMIUM SUBSIDY FOR THE LIFETIMES OF THEN-CURRENT (PRE-2008) RETIREES.

The County pointed to an alleged fiscal crisis to justify its decision to eliminate the Retiree Premium Subsidy, claiming that its confiscation of this critical retirement benefit was necessary to "save" the Retiree Medical Program from insolvency. (ER II: 77:12-14.) Without examination of the record, the District Court adopted this theme – citing "underfunding" of the County's health plans as the basis for the County's decision to eliminate the Retiree Premium Subsidy. (ER I: 2.)

But the County had presented not one shred of *evidence* to suggest that the health plans were underfunded, or that the funding source for the Retiree Premium Subsidy was in any way inadequate to cover the current or projected costs of that benefit. In fact, the County's Public Finance Manager, and designated Person Most Knowledgeable regarding the Board's reasons for eliminating the Retiree Premium Subsidy, was directly asked whether it was financial concerns that led the Board to eliminate the benefit. His response: *"I don't think that [saving money] was a very important issue"* motivating the Board's decision. (ER VIII: 1719:15-20 [emphasis added].)

Further still, the County presented no evidence as to what the cost of the Retiree Premium Subsidy actually was. In its summary judgment briefs, the County boldly and repeatedly alleged that the cost "quite possibly exceed[ed] $400 million" over the next 30 years. (*See e.g*. ER III: 386:6-11; ER VIII: 1807:23-24.) But the County provided no *evidence* to support that assertion. At the summary judgment hearing the District Court attempted to clear up the confusion regarding the projected cost of the Retiree Premium Subsidy, by pressing the County's attorney to explain the $400 million estimate. (ER VIII: 1807:23-24.) The County's attorney referred vaguely to a 2006 "Power Point" presentation to the Board, but then appeared to concede that the $400 million figure was more a rhetorical invention than a reliable estimate: "*The truth of the matter is that we haven't been able to come up with a concrete number as to what this would cost. . . .*" **(**ER VIII: 1807:23-1808:13 [emphasis added].)

A reasonable cost estimate can be derived by starting with the County's own financial documents. The County's 2005 actuarial report estimates that, assuming that the "pool" of retirees is "closed" at Year One, the 30-year gross cost would be $121 million, or approximately $4 million per year. (ER IV:627.)[5] However, gross cost is only the starting point. REAOC's uncontroverted evidence demonstrated that at least *80%* of the gross cost of the Retiree Premium Subsidy was covered by third parties—mostly Federal and State funds—through program reimbursements and contract payments. (ER V: 914:15-25.) Accordingly, the actual cost *to the County* to provide this benefit over a 30-year period would have averaged $800,000 per year, for a *30-year* total of $24 million.[6]

[5] This "closed pool" scenario is the most salient one because it is aligned with the relief that REAOC seeks in this litigation – to reinstate the Retiree Premium Subsidy only for retirees who retired *before* January 1, 2008.

[6] To put these numbers in perspective, the County's annual budget for 2007 was $3.5 *billion*. (ER VI: 1229.)

ARGUMENT

The Ninth Circuit stated the certified question as follows: "Whether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees." (*REAOC v. County of Orange* (9th Cir. 2010) --- F.3d ---, 2010 WL 2593674.) This question presents two separate issues: (1) whether California law recognizes implied-in-fact contract rights and duties, relating to retirement health benefits, in public sector employment; and (2) whether benefits conferred by such terms can become "vested."

The first question is easily answered by California statutory and case law, which has long established that public entities can be bound by implied contractual terms, and that implied terms are common in public and private sector contracts between employers and employees (and employee unions). While no case directly addresses retirement health care benefits, there is no principled reason why such benefits would fall outside the standard rules for establishing and interpreting implied contractual obligations.

With regard to the second issue, the term "vested" must be understood in the context of this dispute. This case presents the limited question of whether retirement health benefits may be unilaterally revoked from *current retirees*; it does not pose the separate question whether and how an employer may alter the *future* retirement health benefits of its *active* workforce. As explained below, this distinction—between active and retired employees' rights to retirement benefits—has been central to courts' consideration of whether changes to such benefits are lawful. It has critical implications for this Court's legal analysis of the question(s) presented, and will significantly reduce the potential financial impact that this Court's confirmation of existing law could have on other municipal employers in California.

Accordingly, REAOC will address its argument to these two issues embedded in the question presented by the Ninth Circuit panel. As explained below, settled principles of California contract law dictate that (1) implied-in-fact contract terms, including terms relating to retirement benefits, *do* arise in public employment; and (2) retired public employees are contractually entitled to receive the retirement health benefits they earned as elements of their compensation.

I. MUNICIPAL EMPLOYERS MAY BE BOUND BY IMPLIED-IN-FACT OBLIGATIONS RELATING TO EMPLOYEE COMPENSATION IF NOT PROHIBITED BY STATUTE.

More than 40 years ago, in *Youngman v. Nevada Irrigation District* (1970) 70 Cal.2d 240, 246-47, this Court held that a municipal employer's two-year practice of providing annual step salary increases to its employees could create an implied-in-fact contract requiring the employer to continue to do so. In *Youngman*, as in this case, the employer's core defense was that it lacked the statutory authority to enter "implied" contracts with employees. (*Id*.) This Court rejected that argument, observing that the district had authority under the Water Code to "employ agents and employees, prescribe their duties, and fix their salaries," and that this authority included the power to enter implied-in-fact contracts:

> There seems little doubt that the general provisions giving the district the power to enter into contracts of employment without specifying any formal requirements for such contracts were intended to apply to both implied and express contracts since the only significant difference between the two is the evidentiary method by which proof of their existence and terms is established. *Governmental subdivisions may be bound by an implied contract if there is no statutory prohibition against such arrangements*.

(*Id*. at 247 [emphasis added].) *Youngman* has been cited numerous times over the decades for the proposition that implied-in-fact terms arise both in government and private sector contracts. (*See, e.g.*, *Air Quality Products, Inc. v. State of California* (1979) 96 Cal.App.3d 340, 349 ["we have no doubt that a public agency may be found liable in appropriate circumstances on the basis of [] an implied-in-fact contract . . ."]; *Caterpillar, Inc. v. Williams* (1987) 482 U.S. 386, 395 n.9 [under California law implied-in-fact contracts arise, in employment relationships, through conduct that takes place both inside and outside the context of collective bargaining agreements]; *California Emergency Physicians Medical Group v. PacifiCare of California* (2003) 111 Cal.App.4th 1127, 1134; *Bell v. Superior Court* (1989) 215 Cal.App.3d 1103, 1108; *see generally* 4 Witkin, Cal. Proc. 5th (2008) Pleading § 526 ["[a]n implied in fact contract arises from conduct, without express words of agreement," for example where a public employer has an announced policy relating to employee compensation]; 10A McQuillin, Municipal Corp., § 29.114 (3d Ed. 2010) ["it is well settled that . . . a municipal corporation in a proper case may be liable . . . upon an implied contract, as distinguished from an express contract. . . . Implied contracts arise where there is a bargained-for exchange intended by the parties, but no overt expression of agreement . . . a municipal corporation may be liable upon an implied agreement in the absence of a law expressly forbidding such a liability."].)

A few years after *Youngman*, this Court held that public sector collective bargaining agreements—so-called Memoranda of Understanding, or "MOUs"—are binding, bilateral contracts. (*Glendale City Employees Association v. City of Glendale* (1975) 15 Cal.3d 328, 334-38; *see also Sonoma County Organization of Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 304 [same]). As such, they are to be construed, like other contracts, according to rules of interpretation set forth in the Civil Code as well as common law doctrines. (*City of Glendale*, 15 Cal.3d at 334-38; *see also City of El Cajon v. El Cajon Police Officers' Assn.* (1996) 49 Cal.App.4th 64, 71 [in construing terms of an MOU, "[w]e are guided by the well settled rules of interpretation of a contract, endeavoring to effectuate the mutual intent of the parties . . ."] [emphasis added]). As this Court noted in *Youngman*, the Civil Code provides that a court's task is to discern and enforce the intent of the parties, whether that intent is set forth in express written words *or implied from the parties' course of dealing*. (Civil Code § 1619 ["A contract is either express or implied."], and 1621 ["An implied contract is one, the existence and terms of which are manifested by conduct."].)

In addition to its general instruction that MOUs are to be construed as contracts, the *City of Glendale* Court observed that special rules developed for the interpretation of private-sector collective bargaining agreements ("CBAs") should apply equally to public-sector CBAs. (*City of Glendale*, 15 Cal.3d at 339-40 & n.17.) One such doctrine is that the express terms of CBAs are necessarily incomplete, and in need of "filling in" by resort to evidence of bargaining history and policies and practices that were deemed acceptable by all parties but were never reduced to express terms. The Court cited its earlier decision in one such private-sector CBA case, *Posner v. Grunwald-Marx, Inc*. (1961) 56 Cal.2d 169, 176-77. (*Id*. at 339-40 & nn. 15-17.) In *Posner,* this Court noted the "inevitable verbal incompleteness" of CBAs, owing to the large number of people and situations they are required to govern, and rejected the proposition that "an employee's claim must fail unless he can point to a specific contract provision upon which the claim is founded," because "[t]here are too many people, too many problems, too many unforeseeable contingencies to make the words of the contract the exclusive source of rights and duties." (*Id.; see also, United Steelworkers of America v. Warrior & Gulf Co.* (1960) 363 U.S. 574, 578-81 [holding that the source of rights and duties under CBAs "is not confined to the express provisions of the contract," because past practices are "equally a part of the collective bargaining agreement although not expressed in it."]; *University of Hawaii Professional Assembly v. Cayetano* (9th Cir. 1999) 183 F.3d 1096, 1099-1104.)

Further underscoring the rule that MOUs include terms that are not expressly set forth in their written provisions, is the *City of Glendale* Court's application of California's liberal parol evidence rule to the interpretation of MOUs. (*City of Glendale*, 15 Cal.3d at 340.) This Court's landmark decision in *Pacific Gas & E. Co. v. G. W. Thomas Drayage etc. Co.* (1968)

69 Cal.2d 33, 40 explains the parol evidence rule. That rule states that, when interpreting a contract, the court must first consider "all credible evidence [including extrinsic evidence] offered to prove the intention of the parties." Next, "[i]f the court decides, after considering this [written and extrinsic] evidence, that the language of a contract, in the light of all the circumstances, is fairly susceptible of either one of the two interpretations contended for . . . extrinsic evidence relevant to prove either of such meanings is admissible." (*Id*. [emphasis added].)

In *City of Glendale*, this Court, relying on *Pacific Gas*, rejected the City's argument regarding the meaning of the relevant MOU, because that argument was "based upon an interpretation of the memorandum on its face *without reference to the extrinsic evidence* . . ." (*Id*. [emphasis added].) The *per se* rule excluding implied-in-fact terms from MOUs—which the County urges and the District Court adopted—necessarily conflicts with this Court's command that (1) evidence extrinsic to the writing must be considered in the interpretation of an MOU, and (2) such evidence may give rise to enforceable implied contract terms in appropriate circumstances.

In addition, this Court has repeatedly held that even standard (that is, not collectively-bargained) employment contracts contain both express terms and terms that arise by implication from the practices, policies and course of dealing established during the employment relationship. In *Scott v. Pacific Gas & Electric Co.* (1995) 11 Cal.4th 454, 463, this Court explained that

> [t]he recognition of implied-in-fact contract provisions is part of the modern trend in contract law . . . [e]vidence derived from experience and practice can now trigger *additional, implied terms* . . . in the employment context the application of this realistic approach to contractual interpretation means that *courts will not confine themselves to examining the express agreements between the employer and individual employees, but will also look to the employer's policies, practices, and communications in order to discover the contents of an employment contract*.

(*Id.* [emphasis added]; *see also Guz v. Bechtel* (2000) 24 Cal.4th 317, 344 [re-affirming "the principle that implied employment contract terms may arise from the employer's official ... policies and practices"].)

The fact that this case deals with the employment relationship in the *public* sector does not alter the analysis. Civil Code section 1635 states that "[a]ll contracts, whether public or private, are to be interpreted by the same rules, except as otherwise provided by this Code." And, more than 80 years ago, this Court explained that

> the contracts of a city or state, when exercising other than governmental functions and within its charter powers, *are construed by the same rules that govern the contracts of private parties* . . . it is a well-settled principle . . . that whenever a government descends from the plains of sovereignty and contracts with parties, such government is regarded as a private person itself, and is bound accordingly.

> *A state in its contracts with individuals must be judged and must abide by the same rules which govern individuals in similar cases*, and when such a contract comes before a court, the rights and obligations of the contracting parties will be adjudged *upon the same principles as if both contracting parties were private persons*.

(*Wills v. City of Los Angeles* (1930) 209 Cal. 448, 450 [emphasis added]; *see also Trimont Land Co. v. Truckee Sanitary Dist.* (1983) 145 Cal.App.3d 828, 831-32 ["Provided the subject of a contract is within the power of a governmental body, a contract between a governmental body and a private party is to be construed by the same rules which apply to the construction of contracts between private persons."]; 10A McQuillin, Municipal Corp., § 29.131 (3d ed. 2010) [" The same rules invoked in the construction of contracts between private individuals and corporations are generally applicable in the construction of municipal contracts. Hence, in reference to matters of contract a municipal corporation is usually regarded and treated as a private person, and its contracts construed in the same manner and with like effect as those of private corporations and natural persons."].)

More recently, in *Kashmiri v. Regents of U.C.* (2007) 156 Cal.App.4th 809, 828-30, the court relied on *Scott* in holding that implied contract terms arise between students and their public university, to reflect the expectations that a university should reasonably anticipate will be created by its course of dealing, student publications, *etc.* Like the County here, the University argued that it could not be held to implied-in-fact terms because it was a governmental entity and therefore could bind itself only through formal "legislation." (*Id.* at 651.) Relying on section 1635, the *Kashmiri* court rejected that argument, concluding that the same rules of contract interpretation apply equally to public and private sector agreements. (*Id.*; *see also Tonkin Construction Company v. County of Humboldt* (1987) 188 Cal.App.3d 828, 831-832 (1987) ["A contract between a governmental body and a private party is to be construed by the same rules which apply to the construction of contracts between private persons . . . One such rule of contract interpretation is that a contract includes not only the terms that have been expressly stated *but those implied provisions* indispensable to effectuate the intention of the parties"] [emphasis added]; *Southern California Gas Co. v. City of Santa Ana* (9th Cir. 2003) 336 F.3d 885, 890-93 [construing municipal contract to include critical implied financial term that reflected parties' decades-long practice].)

Finally, California's Public Employment Relations Board ("PERB")—the body charged with interpreting and enforcing California's public employment statute, the Meyers Milias Brown Act ("MMBA")[7]—

[7] PERB's decisions are entitled to considerable deference by the courts.

recently reiterated this fundamental rule regarding implied contracts in public employment relationships. In *Sacramento County Attorney's Association v. County of Sacramento* (2009) PERB Decision No. 2043-M, PERB ruled that the county's unwritten past practice of providing retiree medical benefits ripened into an implied term in the employment agreement between the county and its employees. As such, the county was required to resort to the bargaining process if it wanted to reduce or eliminate that benefit prospectively from its active employees; unilateral reduction or elimination was a violation of the MMBA. (*Id.*) A number of Court of Appeals decisions concur. (*See, e.g., Vernon Fire Fighters v. City of Vernon* (1980) 107 Cal.App.3d 802 [past practice "was sufficiently widespread and of sufficient duration to constitute an implied condition of employment."]; *International Assn. of Fire Fighters Union v. City of Pleasanton* (1974) 56 Cal.App.3d 959, 972 ["an existing and acknowledged practice" affecting conditions of employment has the same dignity as "an existing agreement or rule."].)

To summarize, the Civil Code and the precedents of this Court, the Court of Appeals, PERB, and federal courts analyzing contracts clause

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(*California Teachers Association v. Public Employee Relations Board* (2009) 169 Cal.App.4th 1076, 1086.)

claims arising under California law, all agree: implied-in-fact contract rights and obligations arise in the context of public sector employment, just as they do in the private sector. As this Court observed in *Youngman*, the only possible exception to this rule is where a statute expressly forbids a public entity to bind itself in this manner. As explained below, there is no such statutory exception in this case.

II. THERE IS NO STATUTE PROHIBITING COUNTIES FROM BINDING THEMSELVES TO IMPLIED TERMS RELATING TO RETIREMENT HEALTH BENEFITS FOR THEIR EMPLOYEES.

Before the Ninth Circuit, the County advanced two arguments in support of its contention that implied-in-fact obligations cannot arise in public employment. First, it contended that State and local statutes require that all terms and conditions of employment for county employees be "expressly" set forth in "formal board legislation," thus rendering any implied-in-fact terms *ultra vires* and void. Second, it argued that public employee compensation is governed by strict principles of statutory construction, rather than principles governing the interpretation of bilateral contracts. Neither argument has merit.

A. There Are No Formal Jurisdictional Limitations On A County's Authority To Bind Itself To Implied-In-Fact Contract Obligations.

The County relied on a line of cases in which courts applied the *ultra vires* doctrine to reject contract claims against public entities, on the grounds that: (1) certain State and local statutes created "jurisdictional prerequisites to the [government's] exercise of the power to contract at all"; (2) the power to contract could be exercised "in no other manner at all"; and (3) the purported contract at issue did not meet these strict formal requirements. (*See Miller v. McKinnon* (1942) 20 Cal.2d 83, 91, *quoting Reams v. L.E. Cooley* (1915) 171 Cal. 150, 154.)

Thus, in *G.L. Mezzetta v. City of American Canyon* (2000), 78 Cal.App.4th 1087, 1093-94, the court held that an alleged oral contract between plaintiff (a food processing company) and the city, to connect the processing plant with the city's sewer system, was void because (1) the California Government Code required all contracts entered into by general law cities to be "in writing" and signed by the mayor or his or her expressly authorized representative and (2) the city code required that all contracts be "approved by the city council, approved as to form by the city attorney, and signed by either the mayor or the city manager." Because none of these explicit procedures was followed, no valid contract was ever formed. (*Id.*)

Similarly, in *First Street Plaza Partners v. City of Los Angeles* (1988) 65 Cal.App.4th 650, the contract claim of the plaintiff (a real estate developer) failed because the purported agreement did not meet the express city charter requirements that contracts be (1) in writing with all material terms set forth; (2) approved by the City Council; (3) signed by the Mayor with (4) the City Attorney's approval as to form. (*Id.* at 662-63.)

The County's *ultra vires* argument fails for a number of reasons.

1. The County Cites No Authority For The Proposition That The *Ultra Vires* Doctrine Governs The Interpretation, As Opposed To The Formation, Of A Contract Between Private Parties And A Public Entity.

The County's cited authorities all address the question whether a contract was ever *formed* between a private party and a public agency; not a single one involves the application of the doctrine where, as here, both parties acknowledge that employment contracts existed, but disagree as to how they should be *interpreted* (that is, whether the contracts include implied-in-fact as well as express rights and obligations). (*See California Teachers Assn. v. Cory* (1984) 155 Cal.App.3d 494, 504 & n.8 [noting importance of distinction between issues of contract formation and contract interpretation in context of contracts clause claims against public entities].)

2. The County's Cited Authorities Are Distinguishable Because They Involved Explicit Statutory Provisions Creating Formal, Technical, And "Jurisdictional" Requirements For The Formation Of Public Contracts.

Even if the County's cited authorities were applicable to the question of contract interpretation, they are plainly distinguishable, because the County can point to no "formal requirements" similar to those that warranted the application of the *ultra vires* doctrine in those cases. The County first relies on Article XI, section 1 of the California Constitution, which states that "[t]he governing body [of a county] shall provide for the number, compensation, tenure, and appointment of employees." The language of this grant cannot be construed as a "formal requirement" that precludes implied-in-fact terms, because it is no more "restrictive" than the Water Code provision that this Court examined in *Youngman*. (*Youngman*, 70 Cal.2d at 246-47 [irrigation district board granted authority to "employ agents and employees, prescribe their duties, and fix their salaries"].) Further, the legislative history behind Article XI, section 1 reveals that it was intended not to restrict county boards' power to set employment terms, or to affect the relationship between counties and their employees and employee unions. Rather, its purpose was to clarify the relationship between counties and the State Legislature, by establishing that the former had the power to set terms of employment for their workers. (*County of Riverside v. Superior Court* (2003) 30 Cal.4th 278, 285-86; *Voters for Responsible Retirement v. Board of Supervisors* (1994) 8 Cal.4th 765, 774.)

The county next points to Government Code section 25300, which states that county boards "*may*" exercise their authority to provide for terms of employment "by resolution of the board of supervisors as well as by ordinance," and to a County Ordinance that states that the regulation of the terms and conditions of County employment shall "be fixed by resolution of this Board." (Codified Ordinances of Orange County Title 1, Div. 3, Art. 1, § 1-3-2.) The County contends that the simple phrase "by resolution" in these two statutes establishes the sort of formal, "jurisdictional" prerequisite that forbids any implied terms from arising in its employment contracts. This argument fails.

First, the County's proposed reading of this phrase would blow a gaping hole in this Court's holding in *City of Glendale*—that MOUs are contracts that should be interpreted according to the established tenets of contract interpretation. (*City of Glendale*, 15 Cal.3d at 334-38.) It also plainly conflicts with this Court's application of California's liberal parol evidence rule to the interpretation of MOUs, as well as its instruction that MOUs should be construed by reference to doctrines of interpretation of private sector CBAs. (*Id.*) It would mean that the court of appeal and PERB have gotten it wrong *every time* they addressed the question whether public sector employment agreements include implied-in-fact terms. It would create a massive "employment contract" exception to the established rules that (1) public sector contracts are construed under the same rules as private contracts, and (2) public sector contracts must be construed to include implied-in-fact terms. The two words "by resolution" simply cannot reasonably be read to carry such weight.

Second, the legislative history of section 25300 reveals that the Legislature did not intend to establish formal requirements for counties to follow in forming contracts with their employees. In fact, its purpose was precisely the opposite; the Legislature added the clause to clarify that the terms and conditions of county employment *need not* be set through the formal procedures required for a county to pass an ordinance. (*Dimon v. County of Los Angeles* (2008) 166 Cal.App.4th 1276, 1284; *see Clean Air Constituency v California State Air Resourses Bd.* (1974) 11 Cal.3d at 801, 813.)

Indeed, in the parlance of municipal law, the phrase "by resolution" imposes no formal requirement whatsoever. Rather, "[a] resolution in effect encompasses *all actions* of the municipal body other than ordinances," and "resolutions, as distinguished from ordinances, need *not* be, in the absence of some express requirement, in any set or particular form." (*Id.* [emphasis added]; *see also City of Sausalito v. County of Marin* (1970) 12 Cal.App.3d 550, 565 ["The Legislature has been explicit concerning this distinction. It has exacted certain formalities in the enactment of an ordinance by the supervisors of a county . . . *but not of their adoption of a resolution*."] [emphasis added and citations and quotations omitted]; 5 McQuillin, Municipal Corporations (2004 rev.3d ed.), § 15:2, pp. 84, 85, 91.)

Here, section 25300 contains no "express requirement" that a board's "resolution" to set a term or condition of employment be in any particular form. Accordingly, to say that a board may set terms and conditions of employment "by resolution" is to say (redundantly) that a board may set terms or conditions of employment by taking "any action" to set terms or conditions of employment. (*Dimon*, 166 Cal.App.4th at 1284-85.) This cannot be read as a jurisdictional formality.

3. The Policies That Inform The *Ultra Vires* Doctrine Are Not Implicated By The Recognition Of Implied-In-Fact Contract Terms In Public Employment.

Finally, the policies underlying the *ultra vires* doctrine do not apply here. The application of the doctrine to public contracting is designed to "ensure that expensive decisions are *not hastily made*," by creating "a broad base of authority requiring approval by a number of different individuals" such that "*[n]o single individual* has *absolute authority* to bind the municipality…." (*G.L. Mezzetta, Inc.*, 78 Cal. App. 4th at 1094 [emphasis added], *quoting First Street Plaza Partners*, 65 Cal. App. 4th at 699.) The doctrine serves a desire "to protect the citizens and taxpayers of the municipality from *unjust, ill-conceived, or extortionate contracts, or those showing favoritism*." 10A McQuillin, Municipal Corp. § 29.2 (3d Ed. 2009) [emphasis added].)

Not one of these concerns is implicated by the courts' continued recognition, under long-established standards of contract interpretation, of implied-in-fact terms in public employment agreements. First, the recognition of implied-in-fact contract terms in public contracts, including public sector employment contracts, has *been* the law for many decades. (*See Youngman*, 70 Cal.2d at 246-47.)

Second, the implied-in-fact contract doctrine guarantees that contractual obligations do *not* arise willy-nilly from just any sort of "practice" or "course of dealing." Under settled precedents, a past practice can become an implied contract term only where it is longstanding, established, recognized and consistent. *See, e.g., Vernon Fire Fighters*, 107 Cal.App.3d 802 [past practice "was sufficiently widespread and of sufficient duration to constitute an implied condition of employment."]; *International Assn. of Fire Fighters Union*, 56 Cal.App.3d at 972 ["an existing and acknowledged practice" affecting conditions of employment has the same dignity as "an existing agreement or rule."]; *Eureka Teachers Association v. Eureka City School Dist.* (1987) 11 PERC 18099 at 12 ("According to traditional labor relations principles, a practice can be an implied term in an agreement . . . if it is clearly established and ascertainable over time, and if it is accepted by the parties.").

And, when considering "course of dealing" evidence to understand what terms the parties' agreement included, courts will *not* credit the isolated acts or statements of individual government representatives, but *will* give weight to the parties' *consistent* conduct over an *extended* period of time, to understand what they considered their agreement to be. (*See Gillespie v. City of Los Angeles* (1951) 36 Cal.2d 553, 561 ["The construction given the contract by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great weight and will, when reasonable, be adopted and enforced by the court."]; 10A McQuillin, Municipal Corp., § 29:122 (3d ed. 2010) ["In the interpretation of contracts of this sort, regard should *not* be had to loose declarations of equivocal or isolated acts; *but the continuous* *conduct of the parties for a series of years concerning the subject matter of the contract and the fulfillment of its conditions, every act pointing in the same direction, is properly admissible in evidence.* The rule embraces acts subsequent to the date of the contract . . ."] [emphasis added].) The application of these standards will ensure that implied-in-fact terms will not "spring up" out of nowhere and place a municipality on the hook for financial liabilities that their governing boards could not reasonably foresee. (*See G.L. Mezzetta, Inc.*, *supra*, 78 Cal. App. 4th at 1094; 10A McQuillin, Mun. Corp. § 29.2 (3d ed. 2009.)

This case presents a paradigm of the sort of practice that ripens into an implied liability with full knowledge and control of the governing board and its duly authorized agents. The undisputed facts here establish that the Board (1) in public session established the Subsidy in 1985; (2) publicly and expressly reaffirmed its "policy and practice" of providing the Subsidy every year for 23 years, with full knowledge of what that benefit was costing for the forthcoming year (and with projections of what it would cost well into the future); and (3) deliberately sent its labor negotiators to the bargaining table to throw the Subsidy into the compensation "pot"—expressly promising that it would continue—in order to win major concessions from the unions.[8]

B. The Doctrine That Terms Of Public Employment Are Generally Controlled By Statute Has No Application Where, As Here, County Retirees Undisputedly Worked Under Contracts.

The County contended that it is not bound by traditional contract principles relating to matters of employee compensation, because such matters are controlled by statute rather than by contract. As support for this proposition the County relies on a line of cases holding that "[t]he terms and conditions relating to employment by a public agency are strictly controlled by statute or ordinance, rather than by ordinary contractual standards" and that therefore "the public employee is entitled only to such compensation as is expressly provided by statute or ordinance." (*Markman v. County of Los Angeles* (1973) 35 Cal.App.3d 132, 34-135; *see also Miller v. State of California* (1977) 18 Cal.3d 808, 813.)

However, as common sense would suggest, the holdings of these cases do not apply where, as here, the plaintiffs undisputedly worked under valid bilateral *contracts*. (*Olson v. Cory* (1980) 27 Cal.3d 532, 537 ["We

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8 In light of these undisputed facts, even if there existed some formal requirement that a County bind itself "by resolution," that requirement was met in this case. All of the actions that the Board took, as described above, were taken "by resolution." Indeed, the Board can act in no other way than by ordinance or resolution.

recognize the often quoted language that public employment is not held by contract and therefore is not protected by the contract clause. . . . On the other hand . . . *[w]hen agreements of employment between the state and public employees have been adopted by governing bodies, such agreements are binding and constitutionally protected.*"] [quoting *City of Glendale*, 15 Cal.3d at 337-338] [emphasis added and citations omitted]; *Shaw v. Regents of University of California* (1997) 58 Cal.App.4th 44, 55 ["We find no merit in the University's suggestion that, as a public employee who is employed pursuant to statute, not contract, Shaw has no vested contractual right in his terms of employment, such terms being subject to change by the University. . . . *When a public employer chooses instead to enter into a written contract with its employee (assuming the contract is not contrary to public policy), it cannot later deny the employee the means to enforce that agreement.*"] [distinguishing *Markman* line of authority] [emphasis added]; *Kemmerer v. County of Fresno* (1988) 200 Cal.App.3d 1426, 1434 [distinguishing civil service plaintiff's contract claims from the implied contract claim permitted in *Youngman*, on grounds that civil service employment is governed by detailed statutory regime, while plaintiff in *Youngman* was permitted to pursue implied-in-fact contract claim because his employment was under a collective bargaining agreement; civil service employment falls under the *Markman*/*Miller* line of authority].) Where such contracts exist – as they do in this case – the rights and duties of public employers and employees are construed under contract principles. (*City of Glendale*, 15 Cal.3d at 337-38.)

III. RETIREMENT HEALTH BENEFITS ARE ELEMENTS OF COMPENSATION THAT CANNOT BE UNILATERALLY REVOKED FROM EMPLOYEES *AFTER* THEY RETIRE.

This case presents the limited question of whether a retirement benefit that accrued to an employee during his or her active employment may be revoked—unilaterally and without compensation—after that employee retires. It *does not* require the Court to decide whether and to what extent an employer may reduce or remove future retirement health benefits from active employees (that is, before they retire), through collective bargaining or otherwise.[9]

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[9] Several courts have highlighted this distinction in the process of deciding the scope and nature of active employees' future rights. (*See San Bernardino Public Employees Ass'n. v. City of Fontana* (1998) 67 Cal.App.4th 1215, 1226 [discussing critical distinction between rights "of employment" and rights "of retirement" and expressly declining to address whether retirement health benefits could be altered by City]; *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System* (9th Cir. 2009) 568 F.3d 725 [examining parties' course of dealing to hold that future retirement health benefits of active employees were not vested but instead were subject to bargaining; expressly noting that City's changes had been prospective only and did not affect current retirees].)

The Ninth Circuit panel correctly observed that this Court has issued no controlling opinion on the specific "vesting" question presented here—whether retired employees have a contractual right to receive the retirement health benefits promised them during their active employment. However, principles well settled in the case law of this State indicate that retired employees do have contractual rights to such benefits, so long as the benefits qualify as deferred compensation. Under the facts of this case, they do.

First, this Court has repeatedly held that public employees have a contractual right to receive the compensation promised them in exchange for work performed. (*Olson v. Cory* (1980) 27 Cal.3d 532, 538 ["[P]ublic employment gives rise to certain obligations which are protected by the contract clause of the Constitution . . . [p]romised compensation is one such protected right."], *citing Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 852-853.) Thus, a retiree's retirement health benefits are protected under the contracts clause if those benefits are properly considered an element of his or her deferred compensation, which they are here.

Second, this Court has observed that retirement health benefits—like pension benefits—are 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 v. Plastic Dress-Up Co.*

(1982) 31 Cal.3d 774, 780.) The United States Supreme Court has reached the same conclusion: "[t]o 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.* (1971) 404 U.S. 157, 180-81.) Accordingly, once an employee retires, "under established contract principles" such benefits "may not be altered without the pensioner's consent." (*Id.* at 181 n.20.)

Even the County itself repeatedly admitted that the Retiree Premium Subsidy was an element of compensation promised to induce employees to take and remain in County jobs. On its website the County (proudly) stated that its package of retirement health benefits—including the Retiree Premium Subsidy—"constitutes an important component of the *total compensation package* the County offers to *attract and retain [its] skilled workforce* . . ." (ER VI: 1233 [emphasis added].) And even during this litigation the County insisted that the Retiree Premium Subsidy was *not* an unconstitutional "gift" of public funds, *because* it was offered for the legitimate "public purpose" of inducing current and prospective employees' faithful service to the County. (County Responding Brief [before the Ninth Circuit Court of Appeals] at 47-48, *citing Sturgeon v. County of Los Angeles (2009)* 167 Cal.App.4th 630, 637-38.)

Third, the Court of Appeal and California Attorney General have held that a public employer may not reduce or eliminate retirement health benefits of retired employees, absent "constitutional justification" (*e.g.*, the reduction is made in response to a public emergency and is of limited duration). (*Thorning v. Hollister School District* (1992) 11 Cal.App.4th 1598, 1603-05, *citing* 67 Ops.Cal.Atty.Gen. 510 (1984).) The *Thorning* court agreed with the Attorney General's conclusion that retirement health benefits are an inducement to take and remain in employment and are properly considered an element of employee compensation. (*Id.*)

Further, the very nature of retirement benefits suggests that employees negotiate over them, and surrender other elements of compensation in exchange, expecting that they will be provided during retirement. *See California School Employees Association v. Madera Unified School District* (2007) PERB Dec. No. 1907 at 2-3 ["PERB decisions have held that future retirement benefits for employees are . . . part of an employee's compensation package. . . *[e]mployees can take their compensation as current wages, present health benefits, or future health/pension benefits*."] [emphasis added], *citing Pittsburg Plate Glass Co.*, 404 U.S.at 180.) It would make little sense for an employee to work for an element of "compensation" when that compensation could be revoked, at will, once he or she began receiving it. (*See Navlet v. Port of Seattle* (S.Ct. Wash. 2008) 194 P.3d 221, 233 [“Without vesting, an employee who retires during the course of any one collective bargaining agreement would lose his or her ability to protect any retirement benefit conferred in that agreement less than three years after receiving the benefit . . . *An employee would reasonably expect that negotiated retirement [health] benefits will continue beyond the current agreement because the employee has no real ability to negotiate for the continuation of such benefits after he or she retires.*"] [emphasis added]; *International Union, UAW v. Yard-Man, Inc.* (6th Cir. 1983) 716 F.2d 1476, 1482 (retirement health benefits vest because they are “status” benefits, like pensions, and “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”].)

Finally, holding that retirement health benefits are not contractually protected would conflict with this State’s public sector labor policies and lead to an absurd result. PERB has repeatedly held that, because an active employee’s *future* retirement health benefits are contractually-protected elements of deferred compensation, they cannot be reduced or eliminated except through the bargaining process. (*See Sacramento County Attorney’s*

Association, PERB Decision No. 2043-M; *California School Employees Association*, PERB Decision No. 1907 at 2-3.) If a county employee's future retirement benefits are protected from unilateral reduction or elimination by the county, then those benefits must also be protected once an employee retires and begins to receive and rely upon them. To hold otherwise would render the "bargaining" requirement a charade. (*Cf. Erie County Retirees' Association v. County of Erie* (3d Cir 2000) 220 F.3d 193, 210 [ADEA protections against age discrimination regarding retirement benefits would be meaningless if those protections ended the moment an employee retires: "It is inconceivable that Congress would in the same breath expressly prohibit discrimination in employee benefits, yet allow employers to discriminatorily deny or limit post-employment benefits to former employees at or after their retirement, although they had earned those employee benefits through years of service with the employer."].)

CONCLUSION

Retirement benefits "are a government obligation of great importance. They help induce faithful public service and provide agreed subsistence to retired public servants who have fulfilled their employment contracts." (*Carman v. Alvord* (1984) 31 Cal.3d 318, 325 n.4.) Municipalities, like private employers, cannot be permitted to use such critical benefits to lure employees into taking, and remaining for decades in, government jobs, and then unilaterally revoke those very benefits once an employee retires and begins to receive and rely on them. The Legislature and the courts have fashioned doctrines of contract interpretation, applicable to both private and public contracts, that give effect to parties' unwritten intentions while protecting them from unforeseen and unreasonable obligations. In light of this authority, "We never put it in writing" is simply not an adequate defense to the legitimate claims of thousands of retirees who are watching their only source of health insurance coverage evaporate before their eyes.

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