LAW OFFICE OF MICHAEL P. BROWN
Michael P. Brown (CASB #183609)
1124 19th Avenue
Seattle, WA 98122
Telephone: (206) 909-3922
E-mail: michael@mpblaw.com

Attorney for Plaintiff

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

RETIRED EMPLOYEES ASSOCIATION OF ORANGE COUNTY ("REAOC"),

Plaintiff,

v.

COUNTY OF ORANGE,

Defendant.

Case No. SACV 07-1301 AG

**PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES ON REMAND**

Date: March 19, 2012
Time: 10:00 a.m.
Place: Courtroom 10D
411 West Fourth Street
Santa Ana, CA 92701
Judge: Hon. Andrew J. Guilford

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## I. INTRODUCTION

REAOC filed this suit in November 2007 to challenge the decision by the County of Orange ("the County") to eliminate the Retiree Premium Subsidy, a retirement health benefit that it had provided to its retirees, and promised to its employees, for 23 consecutive years. REAOC acknowledged from the outset that the promise was not set forth in the express provisions of a written contract or other piece of legislation. It argued, however, that established principles regarding the law of *implied in fact* contract demanded that the County continue to provide this critical benefit to those employees who had retired on or before the County changed its policy, on January 1, 2008.

The County insisted that it was not subject to the law of implied-in-fact contract, because, it argued, all terms of public employment must be set forth expressly in Board legislation. This Court accepted that argument, but the California Supreme Court has now confirmed what REAOC has argued all along: that implied-in-fact contract rights *may* arise in public employment, if the parties' course of conduct clearly demonstrates that the practice became a component of their contractual exchange.

As explained below, REAOC has adduced evidence that clearly and convincingly shows that the 23-year practice of pooling active and retired employees for purposes of setting retiree health premiums, and the Retiree Premium Subsidy that resulted, became a substantial component of the contractual exchange between the County and its employees. The parties' course of dealing also compels the conclusion that, while the County was free to, and in fact did, negotiate with active employees to eliminate this benefit *prospectively*, its contractual obligations prohibited it from revoking the benefit, unilaterally, from existing retirees. The application of the California Supreme Court's opinion can reasonably lead to only one result: REAOC is entitled to summary adjudication on its claims for impairment of contract.

## II. PROCEDURAL BACKGROUND

In November 2007 REAOC filed this lawsuit seeking declaratory and injunctive relief for the County's elimination of the Retiree Premium Subsidy. [Docket No. 1] REAOC's claims for breach of contract and violation of the contracts clauses were premised solely on the theory that pre-2008 retirees had an implied-in-fact contract right to continue to receive that benefit throughout their retirements. [*Id.*] This Court denied the County's motion to dismiss REAOC's claims, acknowledging that REAOC was entitled to rely on a theory of implied-in-fact contract based on the County's historic practice of pooling active and retired employees for purposes of calculating health premiums. [Docket No. 25 at 6-7 ("Plaintiff references Defendant's long-term *practice* of pooling, and the *implied promise* that it would continue … *Plaintiff has alleged an implied contract to maintain the Pooling Benefit*") (emphasis added).]

After months of discovery, in November 2008 the parties filed cross-motions for summary judgment. This Court heard argument on the motions on December 22, 2008. In June 2009, this Court issued an order granting the County's motion for summary judgment, and denying REAOC's motion. *REAOC v. County of Orange*, 632 F. Supp. 2d 983 (C.D. Cal. 2009) ("*REAOC I*"). This Court acknowledged that "public employees are absolutely entitled to retirement benefits provided in contracts properly offered, approved and accepted" by the Board. *Id.* at 983. It held, however, that under California law there existed a *per se* prohibition on reading such contracts to include terms that did not receive the Board's express approval. *Id.* at 986-87 ("cases finding such contractual obligations regarding public pensions base their findings on explicit language in statutes or legislative enactments"). REAOC appealed.

The Ninth Circuit concluded that the law in California regarding implied terms in public employment contracts was unsettled. *REAOC v. County of Orange*, 610 F.3d 1099, 1101 (9th Cir. 2010) ("*REAOC II*"). It certified the following

question to the California Supreme 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." *Id.* The California Supreme Court accepted the certification.

## III. THE SUPREME COURT'S UNANIMOUS RULING IN *REAOC III*

On November 21, 2011 the California Supreme Court provided its unanimous answer to the Ninth Circuit's question: *Yes*, a county and its employees may enter into contracts under which employees, by implication, earn the right to receive certain health benefits throughout their retirement. *REAOC v. County of Orange*, 52 Cal. 4th 1171 (2011) (*"REAOC III"*). The Court's holding is described in more detail below.

### A. Implied-In-Fact Contract Terms May Arise From Parties' Course Of Dealing And Past Practices, And Implied Terms Stand On Equal Footing With Express Terms.

The Court began its analysis with a review of the fundamental tenets of California law with respect to implied-in-fact contract. "A contract is either express or implied," and implied contract obligations arise "from mutual agreement and intent to promise where the agreement and promise have not been expressed in words." *REAOC III*, 54 Cal. 4th at 1178. Further, "even where a written contract exists, evidence derived from experience and practice can now trigger the incorporation of *additional, implied terms*," which "ordinarily stand on equal footing with express terms." *Id.* at 1178-1179 (emphasis added), citing *Scott v. Pacific Gas & Electric Co.*, 11 Cal. 4th 454, 563 (1995).

In *Scott*, the Court had noted that the "modern trend in contract law" was for courts to "seek to enforce the actual understanding of the parties to a contract." *Scott*, 11 Cal. 4th at 463. In so doing, courts should not limit themselves to the parties' express written contract, but instead "may inquire into the parties' conduct" to determine if it demonstrates additional, implied terms. *Id.* In the specific context of employment contracts, "this realistic approach to contract interpretation means

that courts will not confine themselves to examining the express agreements" but "*will also look to the employer's policies, practices, and communications in order to discover the contents of an employment contract*. *Id.* (emphasis added). "[T]here is no rational reason," the Court concluded, "why an employer's policy … cannot become an implied term of an employment contract." *Id.* at 464.

The *REAOC III* Court went on to observe that this incorporation of implied-in-fact terms arising from policies and practices is especially appropriate in the context of collective bargaining. "[I]t is well understood" that in the context of collective bargaining, "resort may be had, in appropriate circumstances, to the parties' practice, usage and custom in interpreting the agreement" and that "such agreements *often* contain implied, as well as express, terms." *REAOC III*, 52 Cal. 4th at 1179 (emphasis added), citing *Consolidated Rail Corp. v. Railway Labor Executives*, 491 U.S. 299, 311-312 (1989) ("collective-bargaining agreements may include implied, as well as express, terms … [i]n this case, Conrail's contractual claim rests *solely upon implied contractual terms, as interpreted in light of past practice*.") (emphasis added).

Underscoring its recognition of the special attributes of collective bargaining agreements, the *REAOC III* Court cited its decision in *Glendale City Employees' Association v. City of Glendale*, 15 Cal. 3d 328 (1975). *REAOC III*, 52 Cal. 4th at 1183. In *City of Glendale*, the Court held that MOUs must be construed to give effect to the mutual intent of the parties at the time of contracting, *and* that MOU interpretation should be guided by recognition of the unique nature of collective bargaining agreements. *City of Glendale*, 15 Cal. 3d at 339-340 & nn. 15-16 (1975), citing *Posner v. Grunwald-Marx, Inc.*, 56 Cal. 2d 169, 177-178 (1962) (express words of collective bargaining agreement are not "the exclusive source of rights and duties" of the parties thereto).

### B. Public Sector Employment Contracts May Include Implied-In-Fact Terms Relating To Retirement Health Benefits Because Such Terms Are Not Prohibited By Statute.

The *REAOC III* Court next examined, and rejected, the County's attempts to use its status as a municipality to escape the application of these settled principles of contract law. First, the Court noted the general rule that "[a]ll contracts, whether public or private, are to be interpreted according to the same rules unless otherwise provided by the Civil Code." *REAOC III*, 52 Cal. 4th at 1179, citing Cal. Civil Code § 1635 and *M.F. Kemper Construction Co. v. City of Los Angeles*, 37 Cal. 2d 296, 704 (1951) ("California cases uniformly refuse to apply special rules of law simply because a governmental body is a party to a contract.").

Next, the Court rejected the County's argument, under *Markman v. County of Los Angeles*, 35 Cal. App. 3d 132, 134-35 (1973), that "the public employee is entitled only to such compensation as is expressly provided by statute or ordinance." *REAOC III*, 52 Cal. 4th at 1180-1181. It held that this generic statement about statutory employment rights did not apply where, as here, employees work under binding, bilateral *contracts* such as MOUs. *REAOC III*, 52 Cal. 4th at 1182-1183. Where the relationship *is* governed by contract, "a county may be bound by an implied contract (or by implied terms of a written contract), as long as there is no statutory prohibition against such an agreement." *Id.*, citing *Youngman v. Nevada Irrigation Dist.*, 70 Cal. 2d 240, 246 (1969).

Having established that *Youngman*—rather than *Markman*—supplies the rule of decision for REAOC's claim, the Court went on to dismantle, one by one, the County's attempts to point to a "statutory prohibition" that would preclude that claim. First, it held that the statutory requirement, that county employee compensation be provided for via board resolutions, did *not* "prohibit" implied-in-fact compensation terms. *REAOC III*, 52 Cal. 4th at 1184. Rather, "[u]nder California law, contractual rights *may be implied* from legislative enactments [such as resolutions] under limited circumstances." *Id.* (emphasis added); *see also id.* at

1185 ("A contractual right may be implied from legislation in appropriate circumstances …").

Second, the Court held that Government Code section 3505.1, which requires that MOUs be presented to the Board "for determination," says nothing about whether those same MOUs, once presented and approved, could be construed to include implied as well as express terms. *Id.* at 1188. In a similar vein, the Court concluded that the recognition of implied terms in MOUs does not violate the "open meeting" requirements of the Ralph M. Brown Act, Government Code section 54953. *REAOC III*, 52 Cal. 4th at 1188. So long as the MOUs on which REAOC relies were themselves approved in open meetings, the Act was not implicated by *interpreting* those MOUs to include implied-in-fact terms. *Id.*

In short, the Court acknowledged that county employee compensation must be provided for by way of Board-approved resolutions. It held, however, that when the Board adopts an MOU, the "legislative approval" requirement—about which this Court expressed great concern in *REAOC I*—is satisfied, not only with respect to the express terms of that contract, but also with respect to any terms that were properly part of that contract *by implication*.

**C. There Is No Special Rule For Implied "Vested" Contract Rights.**

Throughout this case the County has argued that "vested" contract rights must be treated differently from other contract rights, for purposes of determining whether such a right can arise by implication. It repeated that argument in *REAOC III*, and was soundly rebuffed. First, the Court noted that that the County had failed to offer "any legal authority for this distinction" between "vested" and other contract rights. *REAOC III*, 54 Cal. 4th at 1189. It observed that, in the context of this litigation, the term "vested" means only that, once an employee retires under an MOU that contains a promise to provide a retirement health benefit, he or she has earned the right to *receive* that benefit during his or her retirement. *Id.* at 1189 & n.3. And it held that, contrary to the County's argument, "public

employee benefits, in appropriate circumstances, could become vested by implication," and that "vesting remains a matter of the parties' intent." *Id.* at 1189-1190.

### D. To Prevail On Its Implied Contract Claim, REAOC Must Adduce "Clear" Extrinsic Evidence To Support Its Claims.

While reaffirming the settled principle that public employment contracts may include implied terms arising from past practices and course of dealing, the *REAOC III* Court instructed that courts should "proceed cautiously" in identifying such obligations. *REAOC III*, 52 Cal. 4th at 1188. Thus, to prevail here REAOC is required here to make a "clear showing," from the express terms of relevant Board resolutions *or* from the extrinsic "circumstances accompanying [their] passage," that the County and its employee unions intended that the Retiree Premium Subsidy *not* be a mere gratuity that the Board decided to dole out to retirees each year for 23 consecutive years, but instead an element of their bargained-for exchange, of labor for compensation. *Id.* at 1186-1189, citing *California Teachers Association v. Cory*, 155 Cal. App. 3d 494 (1984) ("In California law, a legislative intent to grant contractual rights can be implied from a statute if it contains an unambiguous element of exchange of consideration by a private party for consideration offered by the state."). As explained below, REAOC's extrinsic evidence meets and exceeds this rigorous standard.

## IV. THERE IS NO DISPUTE THAT PRE-2008 COUNTY RETIREES HAD A CONTRACTUAL RIGHT TO RECEIVE THE RETIREE PREMIUM SUBSIDY THROUGHOUT THEIR RETIREMENT.

As the *REAOC III* Court determined, REAOC's claims here present two separate, albeit related, questions: (1) whether a promise to provide the Retiree Premium Subsidy during retirement was an implied-in-fact term in the MOUs in effect during the relevant period; and (2) if so, whether that promise expired when each of those MOUs expired, or "vested" as to those employees who retired while each of those MOUs was in effect. *See REAOC III*, 52 Cal. 4th at 1176-1177.

REAOC will address each question in turn.

### A. The Retiree Premium Subsidy Was An Implied-In-Fact Term In The MOUs In Effect Between 1985 and 2007.

While the *REAOC III* Court confirmed that the "circumstances accompanying" the passage of legislation can create private contractual rights, it did not specifically address, in that portion of its opinion, what sorts of circumstances give rise to such implied rights in the context of public sector collective bargaining and legislation related to same. *REAOC III*, 52 Cal. 4th at 1185-1191. However, early in its opinion, the Court observed that "evidence derived from [the parties'] *experience and practice* can now trigger the incorporation of additional, implied terms." *REAOC III*, 52 Cal. 4th at 1178-1179, quoting *Scott*, 11 Cal. 4th at 463-64 (1995) ("implied employment contract terms may arise from the employer's official and unofficial policies and practices"); *see also Guz v. Bechtel Nat. Inc.*, 24 Cal. 4th 317, 336-37 (2000) ("The contractual understanding need not be express, but may be implied in fact, arising from the parties' conduct," including "the personnel policies or practices of the employer").

The *REAOC III* Court also noted that, in interpreting collective bargaining agreements, "resort may be had, in appropriate circumstances, to the *parties' practice*, usage and custom," and that "such agreements *often* contain implied, as well as express terms." *REAOC III*, 52 Cal. 4th at 1179, quoting *Conrail, supra*, 491 U.S. at 311-312 (emphasis added); *see also United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 579 (1960) (the source of parties' rights and obligations 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.") (emphasis added).

Finally, the Court cited *Sappington v. Orange Unified School Dist.*, 119 Cal. App. 4th 949, 954-955 (2004) for the proposition that, in the context of public sector employment, courts may resort to "extrinsic evidence of the parties' course of

conduct" to determine whether the employment agreement included an implied promise to provide a particular retiree health benefit throughout retirement. *REAOC III*, 52 Cal. 4th at 1190. While *Sappington* did not involve collective bargaining agreements, the *REAOC III* Court observed that *Sappingtons*'s "analytical approach" to the question "belies" the County's argument that vested retirement benefits cannot be implied, from past practices, in the public employment context. *Id.*

The analysis mandated by *REAOC III* has long been followed by the California Public Employment Relations Board ("PERB"), the body charged with administering the MMBA and disputes involving the interpretation of MOUs. PERB decisions plainly recognize that MOUs contain both express terms and implied-in-fact terms arising from the parties' practices. *See Eureka Teachers Association v. Eureka City School Dist.*, 11 PERC 18099 at 12 (ALJ) (1987) ("According to traditional labor relations principles, a practice can be an implied term in an agreement …"). Indeed, PERB has specifically held that a county's historic practice of *subsidizing retiree healthcare* crated an implied-in-fact term in the MOU that the county could not alter, as to active employees, without resort to the bargaining process. *Sacramento County Attorneys Assoc. v. County of Sacramento*, PERB Dec. No. 2043 at 11 (2009) (noting "the established principle that a binding policy may be established through a consistent course of conduct that is a historic and accepted practice").

This Court is asked to determine whether the "context" or "circumstances accompanying" the Board's passage of legislation—its adoption of MOUs and its perpetuation of the pooled rate structure/Retiree Premium Subsidy—created an implied-in-fact contract right. The above authorities demonstrate that one key "circumstance" to which this Court should look is the past practice, or course of dealing, between the parties with respect to that purported right. Of course, not just any "past practice" becomes an implied-in-fact promise. Courts have derived

standards by which to evaluate past practices, to determine whether they can fairly be said to comprise an element of the parties' contractual exchange.

**1. The Duration And Consistency Of The Practice**

The primary factor that courts consider is the duration and consistency of the practice at issue. For example, in *Southern California Gas Co. v. City of Santa Ana*, 336 F.3d 885 (9th Cir. 2003), the Ninth Circuit held that a contract between the gas company and the city included an "implicit financial term" that arose from the parties' decades-long course of dealing. The contract (a franchise agreement entered by way of a city ordinance) explicitly granted the gas company the right to excavate city streets as needed to provide gas services to city residents, so long as it made necessary repairs after such work was completed. *Id.* at 887. The express terms said nothing about whether the city could charge the gas company to exercise that right to excavate. However, for decades the parties' practice had been to allow the gas company to excavate and repair *without* paying fees to the city. *Id.* at 891-93. The Court held that the city's attempt, in 2001, to begin charging the gas company an "excavation" fee violated the Contracts Clause because it worked an "adjustment to *implicit financial terms*" in the parties' contract, terms that had been established by the parties' long, repeated and consistent course of dealing with regard to the issue of excavation fees. *Id.* at 890-93 (emphasis added); *see also Pacific Gas and Elec. Co. v. City of Union City*, 220 F. Supp. 2d 1070, 1087-88 (N.D. Cal. 2002) (same for 30-year practice of allowing gas company to excavate and repair streets for free).

In *University of Hawaii Professional Assembly v. Cayetano*, 183 F.3d 1096 (9th Cir. 1999), the collective bargaining agreement between the state and its employees was silent as to which days of the month employees were to receive their paychecks. However, the established practice between the parties was for employees to receive their paychecks on the 15th and final days of each month. The Court held that the state's attempt to change that policy, by instituting a "pay lag,"

was an unlawful impairment of contract. It reasoned that, while the express terms of the CBA were silent regarding pay dates, "[a] course of dealing can create a contractual expectation" protected by the Contracts Clause. *Id.* at 1102. It focused on the fact that the state's practice of paying on the same two days every month had been consistently followed throughout the preceding 25 years. *Id.* at 1102-1104. As such, the past practice had become an "implicit financial term" in the parties' agreement. *Id.*

PERB decisions likewise have held that the duration and consistency of a practice is critical to determining whether it has become an implied term in an MOU. In *Sacramento County Attorneys Assoc.*, PERB Dec. No 2043 at 11, the Board held that a county's consistent, 20-year practice of subsidizing retiree healthcare was established and longstanding enough to ripen into an implied MOU term. *Id.* In reaching that conclusion, the Board distinguished a case in which the Eighth Circuit held that an employer's "practice" of giving bonuses in three of the prior five years was in the nature of a "gift," and was *not* sufficiently longstanding and consistent to give rise to an implied-in-fact term requiring that such bonuses continue. *Id.* at 9 n.6, citing *N.L.R.B. v. Wonder State Manufacturing Co.*, 344 F.2d 210, 214 (8th Cir. 1965).

Here, there is no dispute that the County maintained the pooled rate structure—and provided the Retiree Premium Subsidy that resulted from that structure—for 23 consecutive years. [Docket No. 135 at 2:20-24.] Indeed, that benefit was paid to retirees every month for ***276 consecutive months***—each time a retiree paid a medical premium that reflected the County-provided rate subsidy. [*Id.*] Under the precedents discussed above, this undisputed duration and consistency provide "clear" and "convincing" evidence that the practice of providing the Retiree Premium Subsidy became an implied promise in the MOUs in effect during those 23 years. *See Cayetano*, 183 F.3d at 1099 (25-year practice established implied-in-fact term); *AFSCME Local 2957 v. City of Benton, Arkansas*,

513 F.3d 874, 877-879 (8th Cir. 2008) (city's 15-year practice of paying retiree premiums became implied promise in CBA); *Bonnell/Tredegar Industries, Inc. v. N.L.R.B.*, 46 F.3d 339, 343-45 (4th Cir. 1995) (employer's use of same formula to determine Christmas bonus for over eighteen years became a term of the collective bargaining agreement); *Intermountain Rural Electrical Assoc. v. N.L.R.B.*, 984 F.2d 1562, 1568 (10th Cir. 1993) (seven-year practice of using paid time off as part of overtime calculation became an implied term of collective bargaining agreement).

**2. The Parties' Bargaining History**

The contracting parties' history of negotiations can provide further evidence that a practice was intended to be an element of their contractual exchange. In *General Motors Corp. v. Romein*, 503 U.S. 181 (1992), General Motors argued that its right to withhold workers' compensation benefits from employees, pursuant to a 1981 Michigan statute regarding coordination of benefits, was an implied-in-fact term in the CBAs between it and its unions. The United States Supreme Court rejected that argument. It first reaffirmed the settled rule that "the terms to which the contracting parties give assent may be express or implied in their dealings." *Id.* at 188. It held, however, that the company's right to withhold under the 1981 statute could *not* have been such an implied term in those CBAs, because they had been negotiated *prior to* the 1981 statute. *Id.* As such, the Court reasoned, the parties could not possibly have considered the matter of benefits coordination in their negotiations, and the unions had no opportunity to indicate assent, or objection to, the company's practice. *Id.* By contrast, in *Cayetano*, *supra*, the Ninth Circuit held that the state's practice of paying employees on same two days of each month *had* become in implied promise in the CBAs because, *inter alia*, "at the time the collective bargaining agreement was negotiated, the timing of the payroll was a *negotiable matter*." *Cayetano*, 183 F.3d at 1102 (emphasis added).

Here, there is no dispute that the structure of the insurance premium rate pool, and more specifically the County's subsidization of retiree health premiums, was a

"negotiable" matter between the parties throughout the relevant period. Indeed, it is undisputed that, from the very early days of the Retiree Premium Subsidy, that benefit was explicitly discussed at the bargaining table. [Docket No. 128 at ¶ 11(b); Docket No. 124 at ¶ 11; Docket No. 125 at ¶ 6.]

Moreover, it is undisputed that during extensive labor negotiations between 1991 and 1993 over retiree health benefits, the Board used the existence of the Retiree Premium Subsidy, *and* a representation that it would continue to provide it, to convince the unions to agree to its proposal for financing a new retiree health benefit (the "Grant" benefit). [Docket No. 128 at ¶¶ 14-16; Docket No. 124 at ¶¶ 16-18; Docket No. 125 at ¶¶ 10-11, 14-15 & Exhs. D-G.][1] During those negotiations, the Board's authorized chief negotiator quantified the monthly cash-value of that benefit to each employee/retiree (approximately $270 per month in 1992), and placed the benefit and its cash value on a chart along with the average monthly pension benefit and the value of the proposed new Grant benefit. [Docket No. 125 at ¶¶ 12-13, Exhs. A-C; Docket No. 150 at ¶¶ 2-3 & Exhs. A-B.]

The fact that the Retiree Premium Subsidy was "equally a part of the collective bargaining agreement although not expressed in it," *Warrior & Gulf*, 363 U.S. at 579, was re-confirmed by the County and the unions in 2005 through 2006, when they negotiated to *remove* that term from the existing MOUs to permit the Board to split the pool and segregate retirees into their own rate pool. In sworn testimony, the County's chief labor negotiator—Shelly Carlucci—expressly

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[1] Central to that negotiation was a dispute over who had rights to a $200 million pension reserve fund. [*Id.*] The County argued that the money belonged to it, while the unions argued that it belonged to employees. [*Id.*] Using the promises relating to the Retiree Premium Subsidy, *inter alia*, the Board's negotiator convinced the unions to agree to the County's proposal to set aside $50 million to fund the new Grant benefit, and give the County the remaining $150 million. [*Id.*]

acknowledged that the Board could not *unilaterally* split the pool because (1) the Retiree Medical Program—which included the Retiree Premium Subsidy—"was in our MOU," and as such the proposed changes to that program involved "making changes with the MOU"; and (2) any changes to the MOUs had to be negotiated with active employees through their unions. [Docket No. 127-2, Exh. A at 24-25.] Ms. Carlucci further testified that during that period "one of the changes [she] negotiated to the MOU was the splitting of the pool." [*Id.* at 20:24-21:1.] Further, she confirmed that, when the proposed new MOUs were submitted to the Board for review, those MOUs included notations directing the Board's attention to the fact that the splitting of the pool (that is, the elimination of the Retiree Premium Subsidy) was a "change" to the terms of the prior MOUs. [*Id.* at 22:10-23:23.]

These facts demonstrate, clearly and convincingly, that the Retiree Premium Subsidy was made a part of the employment *bargain* between the County and its employees, along with the (express) promises of pension and Grant benefits. Or, to use the words adopted by the California Supreme Court in *REAOC III*, this evidence of bargaining history provides the "context" to prove that the practice of pooling rates had taken on an "unambiguous element of *exchange* of consideration" between the County and its employees. *REAOC III*, 52 Cal. 4th at 1186, quoting *California Teachers Assoc.*, *supra*, 155 Cal. App. 3d at 505 (emphasis added).

**3. Whether The Practice Was "Recognized"**

Another factor to which courts look in deciding whether a practice became an implied promise is whether the practice was "recognized" and "accepted" by the parties during the period in question. *See Bonnell/Tredegar*, 46 F.3d at 344 ("Past practices rise to the level of an implied agreement when they have ripened into an established and *recognized custom* between the parties.") (emphasis added); *Sacramento County Attorneys Assoc.* PERB Dec. No. 2043 at 11 (noting "the established principle that a binding policy may be established through consistent course of conduct that is a historic *and accepted practice*") (emphasis added);

*Brotherhood of Maintenance of Way Employees v. Chicago & North Western Transp. Co.*, 827 F.2d 330, 334 (8th Cir. 1987) ("the parties' longstanding and *recognized* custom and practice … has become an implied term in the agreement of the parties"). Here again, the undisputed facts demonstrate that the Retiree Premium Subsidy was well-recognized by the parties.

First, as discussed above, there is no dispute that the Board and the unions "recognized" the pooled rate structure, and the Retiree Premium Subsidy that resulted from it, from the inception of that practice. [Docket No. 124 at ¶¶ 10-11; Docket No. 125 at ¶¶ 5-6; Docket No. 128 at ¶¶ 9-11.] Indeed, these matters were specifically discussed during litigation between the County and its unions over the subject of retiree health benefits. *See Orange County Employees Assoc. v. County of Orange*, 234 Cal. App. 3d 833, 838 (1991) ("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 county.") (emphasis added). There is no dispute that the Board and the unions recognized the Retiree Premium Subsidy, and its substantial value to employees as a future retirement benefit, during the labor negotiations over retiree medical benefits that took place from 1991 through 1992. *See supra* section 2.

And there is no dispute that the Board "recognized" its policy and practice of pooling rates, and thereby subsidizing retiree premiums, *every time* it expressly approved annual health premium rates for the "pooled" health plan, from 1985 through 2007. The County's employee benefits consultant prepared, at the Board's request, annual memoranda regarding the premium rates that the Board was about to approve. [*See* Docket No. 128-2 at 9; Docket No. 127-4 at 1-96.] Those memoranda were appended to the rate legislation that the Board reviewed before approving each year's rates. The 1990 version explained that "[t]he 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 … [t]his *practice* has resulted in the following … retirees … *are being subsidized by the County*." [Docket No. 128-2 at 9.] It went on the quantify the cost of the Retiree Premium Subsidy for that year ($1.5 million) and explained that retiree premiums would more than double if the County stopped providing that benefit. [*Id.*] The Board received and reviewed 15 similar memoranda *every year* throughout the relevant period; each one (1) repeated the explanation of the pooled rate structure and the resulting retiree subsidy; (2) characterized it as the Board's "policy" and "practice"; and (3) quantified its projected cost. [Docket No. 127-4 at pp. 1-97.]

The Board not only recognized the "practice" of rate-pooling and subsidizing retiree premiums, it recognized this practice *as a benefit of employment* that it offered its employees, that is, as an element of the bargained-for exchange of labor for compensation. This is reflected, first, in the Board's characterization of the Retiree Premium Subsidy (through its authorized labor negotiator) during the 1991 - 1993 labor negotiations, as a benefit that, like pensions and the new Grant benefit, had significant monthly cash value. [Docket No. 125 at ¶¶ 12-13 & Exhs. A-C; Docket No. 150 at ¶¶ 2-3 & Exhs. A-B.] It is also reflected in a 1998 actuarial report that the Board commissioned to study its future retiree medical liabilities. That report described the Retiree Premium Subsidy as a "Retiree Medical *Benefit*" no fewer than seven times. [Docket No. 127 at p. 3:19-22; Docket No. 127-5 at 6-10.] It treated the Subsidy as a "benefit *earned* based on service rendered," and quantified the value of that benefit for an individual 62 year-old retiree in 1997 ($329 per month), 1998 ($354 per month) and 1999 ($378 per month). [Docket No. 127-5 at 6, 15 (emphasis added).]

Finally, the Board's recognition of the Retiree Premium Subsidy as a benefit is plainly reflected in a Request for Proposal that the County Counsel prepared in 2006 to recruit litigation counsel to defend the Board's decision to "split the pool." [Docket No. 127 at 5:25-28; Docket No. 127-8 at 69-71.] In that RFP, County

Counsel explained that the Retiree Premium Subsidy was one of the "*post-employment benefits*" that the County "currently offers" its employees. [Docket No. 127-8 at 70-71 (emphasis added).] It went on to characterize the Subsidy as a retiree medical benefits "program," despite the fact that it was "not expressly included in the Plan or any memorandum of understanding or other agreement with employee bargaining units." [Docket No. 127-8 at 71 (emphasis added).]

### B. Every Employee Who Retired Between 1985 and 2008—While The Retiree Premium Subsidy Was An Implied Term In The MOUs—Earned The Right To Receive That Benefit Throughout His Or Her Retirement Years.

As set forth above, REAOC has established, clearly and convincingly, that the Retiree Premium Subsidy was an implied-in-fact term in the MOUs in effect from 1985 through 2007. Accordingly, for this second portion of the analysis—the issue of the "duration" of that promise—the MOUs in question must be read as if they *expressly stated* that retiree health insurance premiums would be calculated based on the commingled pool of active and retired employees. *REAOC III*, 52 Cal. 4th at 1178 (there is "no difference in legal effect" between implied-in-fact terms and express terms, and that the former "ordinarily stand on equal footing" with the latter); *Youngman*, 70 Cal. 2d at 246 (in context of public sector employment, holding that "the only significant difference" between implied and express terms "is the evidentiary method by which proof of their existence is established"); *Bonnell/ Tredegar*, 46 F.3d at 346 (CBA terms derived from past practice are "as binding and enforceable as express terms of the agreement").

The County's apparent contention is that, even if the Retiree Premium Subsidy was an implied promise in the MOUs, that promise "expired" when each MOU expired (approximately every two years) throughout the relevant period. As such, an employee who retired while one of these MOUs was in force had, at most, a contractual right to receive the benefit for the duration of *that* MOU (that is, for one day to, at most, two years). That argument cannot be correct.

As the *REAOC III* Court made clear, not once but twice, vesting "is a matter of the parties' intent," and that intent can be demonstrated through the parties' past practices and course of dealing. *REAOC III*, 52 Cal. 4th at 1177; *id.* at 1190 (noting that in *Sappington*, *supra*, "the court relied on … extrinsic evidence of the parties' course of conduct" to determine whether a retiree medical benefit was "vested" as to particular retirees); *see Bower v. Bunker Hill Co.*, 725 F.2d 1221, 1224-25 (9th Cir. 1994) (finding that extrinsic evidence, including provision of retiree health benefits after CBA expired, indicated intent that such benefits vest as to retirees); *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). Here, extrinsic evidence clearly and convincingly establishes that the parties intended the Retiree Premium Subsidy to "vest" as to each employee who retired while it was in effect and an implied term in the MOUs.

**1. The Parties' Course of Dealing With Respect To "Vesting"**

It is undisputed that the parties' practice for 23 years was for retired employees to continue to receive the Retiree Premium Subsidy *indefinitely* after they retired, and after the MOU under which they retired had "expired" with respect to its other terms and conditions. [Docket No. 135 at 2:20-24.] Further, REAOC adduced evidence in the form of testimony from former senior County human resources senior managers that it was the County's historic policy and practice *not* to significantly alter retirement health benefits of *existing* retirees. [Docket No. 125 at ¶ 16; Docket No. 128 at ¶ 21; Docket No. 124 at ¶¶ 20-21.] That course of dealing demonstrates that the parties intended that employees who retired under an MOU that contained this retiree medical benefit, would receive the benefit not just for the duration of their "last" MOU, but throughout their retirement. *See Jensen v. SIPCO, Inc.*, 38 F.3d at 945, 951 (8th Cir. 1994) ("all the changes [employer]

unilaterally made to its retiree benefits … were prospective only," and employer's "policy of not changing the benefits of prior retirees" is "consistent with the concept of vested benefits"); *Angotti v. Rexam, Inc.*, 2006 WL 1646135 at *10 (N.D. Cal. 2006) ("extrinsic evidence of intent to vest" included employer's "conduct prior to this dispute, which never involved a significant termination or reduction in benefits").

**2. Extrinsic Documentary Evidence**

Health plan documents that the County provided to employees indicated that, "[w]hen you retire from the County and receive a monthly retirement check, you will be eligible to continue with the [health] plans" that active employees participate in. [Docket No. 128-3 at 6; 128-3 at 73; 128-2 at 56.] There was no mention of any "limit" on employees' rights to remain enrolled in those plans. By contrast, the very next paragraph in these booklets specifically states that, upon *termination* of employment (other than retirement), "coverage ends on the last day on which you were employed by the County." [*Id.*]

Further still, these documents expressly link a retiree's eligibility to remain enrolled in the health plans during retirement, with eligibility to receive a pension check. [*Id.*] The Ninth Circuit has held that this linkage tends to indicate that the two rights are coterminous, that is, both last for the duration of a retiree's lifetime. In *Bower*, in examining extrinsic evidence of an intent that retirement health benefits vest, the Ninth Circuit observed that "[a] small booklet distributed to all employees," which described the company's retirement benefits, "stated only one eligibility requirement for receiving insurance: that the applicant be 'receiving a pension from the Bunker Hill Company.'" *Bower*, 724 F.2d at 1224. The Court concluded that, "[s]ince the pension is lifelong, *employees may have viewed the related insurance also to be a lifelong benefit*." *Id.* (emphasis added); *see also Yolton v. El Paso Tennessee Pipeline Co.*, 435 F.3d 571, 581 (6th Cir. 2006) (linkage of retirement health benefit eligibility with pension eligibility indicates that

parties intended for *current* employees' future retirement health benefits to be subject to changes through collective bargaining, but that "someone *already retired under a particular CBA* continues to receive the benefits provided therein despite the expiration of the agreement itself") (emphasis added).

If the duration of the right to remain enrolled in the health plans was not limited to the duration of the "retirement" MOU, but instead was throughout retirement, then the closely related implied right to remain in the "commingled plans," and thereby pay premiums based on the pooled rate, must be as well. In fact, the Health Plan Booklets did address the subject of retiree *premiums*, by stating that "retiree rates are based on the full monthly premium for each plan." [Docket No. 128-3 at 6; 128-3 at 73; 128-2 at 56.] While "full monthly premium" is not defined in the booklet, the parties' 23-year course of dealing clearly defined that term as full monthly premium *based on* the commingled health plans.

**3. The Nature Of Retirement Benefits**

Another compelling item of extrinsic evidence is the nature of retirement benefits, and the role they play in the contractual employment relationship. For decades federal courts have recognized that retirement health benefits are an element of "promised compensation," and therefore represent contractual rights of employees and retirees. *Allied Chemical and Alkali Workers of America, Local Union No. 1 v. Pittsburg Plate Glass*, 404 U.S. 157, 180-81 & n.20 (1971) ("To be sure, the future retirement [health] benefits of active workers are part and parcel of their overall compensation," and "under established contract principles," those terms "may not be altered without the pensioner's consent"); *International Broth. of Elec. Workers, AFL-CIO Local 1245 v. Citizens Telecom. Co.*, 549 F.3d 781, 786-87 (9th Cir. 2008) (citing *Pittsburg Plate Glass* to conclude that "future retirement benefits are part and parcel of an active employee's compensation").

The California Supreme Court likewise has held that retirement health 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.*, 31 Cal. 3d 774, 780 (1982) (emphasis added). The *REAOC III* Court cited its prior *Suastez* decision twice regarding the status of post-employment benefits as a form of deferred compensation. *REAOC III*, 54 Cal. 4th at 1185, 1190-1191. The *REAOC III* Court also noted the Washington State Supreme Court's holding (in the context of public employment) that, "[i]n 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." *See Navlet v. Port of Seattle*, 194 P.3d 221, 232 (S.Ct. Wash. 2008) (emphasis added) (cited in *REAOC III*, 52 Cal. 4th at 1191). Finally, "PERB decisions have held that future retirement benefits for employees are … part of an employee's *compensation package*," and that "employees can take their compensation as current wages, present health benefits, *or future health/pension benefits*." *California School Employees Assoc. v. Madera Unified School District*, PERB Dec. No. 1907 at 2-3 (2007) (emphasis added).

The County itself has admitted that the Retiree Premium Subsidy was an element of employee compensation. Indeed, until recently, the core of the County's defense in this case has been that a promise to pay a retirement health benefit is *by definition* a promise to pay *compensation*, and as such must be "expressly conferred" in Board legislation. Even during the hearing before the California Supreme Court, the County's attorney characterized the Retiree Premium Subsidy as "compensation of sorts." REAOC RJN, Exh. A at 21:7-20.

Further, in its attempt to explain why providing the Retiree Premium Subsidy for 23 years was *not* an unlawful "gift of public funds," the County argued that the benefit fell within an established exception for public expenditures that "serve a public purpose." REAOC RJN, Exh. B at 47. The "public purpose" that the County invoked was this: the provision of retirement benefits to public employees allows the government to recruit and retain the workforce that it needs to conduct its

business. *Id.*, quoting and citing *Sturgeon v. County of Los Angeles*, 167 Cal. App. 4th 630, 637-38 and 640 (2008). Of course, to use a retirement benefit for the public purpose of "recruiting and retaining" employees is necessarily to make that benefit an element of promised *compensation*.[2]

The fact that the Retiree Premium Subsidy was an element of employee compensation is convincing evidence that the parties intended it to be paid *throughout* an eligible employee's retirement. It would make little sense for the parties to a contract to bargain for an exchange of labor for compensation, when one element of that compensation—compensation deferred until retirement—simply disappeared shortly after the employee retired. Indeed, as the *REAOC III* Court noted, in *Navlet* the Washington Supreme Court found this "reasonable expectation" factor to be dispositive with regard to the duration of public sector retirement health benefits. *REAOC III*, 52 Cal. 4th at *11. In *Navlet*, the court held that, unless an employee who retired under a CBA secured a right to retirement health benefits throughout his or her retirement, at the moment of retirement he or she would "lose his or her ability to protect *any* retirement benefit conferred in that agreement *less than three years after receiving the benefit*." *Navlet*, 194 P.3d at 233 (emphasis added). It observed that "[a]n 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." *Id.* (emphasis added).

In reaching that common-sense holding, the *Navlet* court relied on the Sixth Circuit's decision in *International Union, UAW v. Yard-Man, Inc.*, 716 F.2d 1476,

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[2] In a 2007 Annual Financial Report posted on the County's website, the County acknowledged that the Retiree Premium Subsidy was "an important component of the *total compensation package* the County offers to *attract and retain the skilled workforce* …" [Docket No. 147 at p. 30 (emphasis added).]

1482 (6th Cir. 1983). In that case, the court held that one significant item of evidence regarding the "vesting" of retirement health benefits was the fact that retirement benefits are "status" benefits, and "when the parties contract for benefits which accrue upon the achievement of retiree status," they "likely intended those benefits to continue as long as the beneficiary remains a retiree." *Id.* The Ninth Circuit approvingly cited *Yard-Man* in a case in which it held that the question of the "vesting" of retirement health benefits should be answered by resort to extrinsic evidence. *Bower*, 725 F.2d at 1223; *see also Alday v. Raytheon Co.*, 2008 WL 3200774 at *5 (D. Ariz. 2008) ("This Court will look to *Yard-Man* as a contextual guide for interpreting the CBAs … the *Yard-Man* court recognized that after *Allied Chemical* … when active employees bargain for retirement benefits it would be unlikely that they would leave these benefits to the contingencies of future negotiations, especially because retirement benefits are 'typically understood as a form of delayed compensation or reward for past services').

**4. The County's "Vesting" Cases Support REAOC's Position.**

The County has relied on *San Bernardino Public Employees Assoc. v. City of Fontana*, 67 Cal. App. 4th 1215 (1998), for the proposition that public sector retirees have no contractual right to their retirement health benefits. However, *City of Fontana* said *nothing* about retirement medical benefits at all, let alone the rights of current retirees to such benefits. In fact, there is no indication in that case that the city was *attempting* to alter the medical benefits of current retirees, and the court expressly declined to address the legality of the city's proposed changes to *current* employees' *future* retirement health benefits, because the parties were still negotiating that matter. *Id.* at 1221, 1226.

What the court did address in *City of Fontana* was current employees' rights under the Contracts Clause to block changes—even negotiated changes—to the rules under which they would continue to accrue personal leave and longevity benefits *prospectively*. *Id.* at 1222-1223. The court deemed these benefits to be

"rights of employment," which are earned "on a year to year basis." *Id.* While an employee has a protected right to such benefits to the extent that they accrued under the prior MOU, he or she has no contractual right to *continue* to accrue additional benefits on those same terms. *Id.* Rather, with regard to the new rules that will apply prospectively, the parties are free to negotiate. *Id.*

In reaching this conclusion, the court observed that, by contrast, "rights of retirement" *are* protected by the Contracts Clause. *Id.*, citing *Vielehr v. State of California*, 104 Cal. App. 3d 392, 395-96 (1980) (change in rules governing what employees may do with funds in their pension account when they leave employment *other than by retirement* do not implicate Contracts Clause because, when a person makes this election, "[h]e does so as an employee, not as a retiree."). Thus, a careful reading of *City of Fontana* clearly *supports* REAOC's position. To state the obvious, in the taxonomy of *City of Fontana* and *Viehler*, the Retiree Premium Subsidy is a "right of retirement," rather than a "right of employment."[3] As such, the County was not free to reduce or eliminate that benefit without impairing a protected contractual right.

The County also relies on *San Diego Police Officers' Assoc. v. San Diego City Employees' Retirement System*, 568 F.3d 725 (9th Cir. 2009) ("*SDPOA*"). However, in *SDPOA*, the city had imposed its changes on retiree health benefits *prospectively* only, that is, on current employees (future retirees). *Id.* at 739. The court took care to make this observation at the beginning of its discussion. *Id.* Further, the *SDPOA* Court premised its holding—that current employees had no vested right to "freeze" the current terms of their future benefits—based on one crucial observation: the evidence of the parties' course of dealing indicated that the

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[3] For example, once retired, an employee *cannot* "negotiate" new terms under which he or she will "accrue" retirement health benefits prospectively, and when retirees exercised their rights to receive health benefits, they do so "as retirees."

future health benefits of *current employees* "were considered a term of employment that *could be negotiated through the collective bargaining process*." *Id.* at 740 (emphasis added), citing *City of Fontana*, *supra*.

Here again, the County's authority supports REAOC's position. If the future retirement health benefits of active employees are not vested *because* they can be "negotiated through the collective bargaining process," then by the same token the retirement health benefits *of retirees* must *be* vested, because, by everyone's admission, those benefits are *cannot be and were not*subject to negotiation.

## V. CONCLUSION

For the foregoing reasons, the Court should grant REAOC's motion for summary adjudication of its contract and Contracts Clause claims.

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Respectfully submitted,

LAW OFFICE OF MICHAEL P. BROWN

By: */s/ Michael P. Brown*
Michael P. Brown

Attorney for Plaintiff REAOC