
ASSOCIATION OF LEGAL PROFESSIONALS ~ ALP

May 6, 2013

Alex Gurza
Deputy City Manager
City of San Jose
200 E. Santa Clara St.
San Jose, CA 95113

Re: ALP's Response to City's Retiree Healthcare Modified Proposal

Dear Mr. Gurza:

This letter responds to the City's retiree healthcare proposal dated April 22, 2013. As always, ALP is committed to working cooperatively with the City to find fair and equitable solutions to the retiree healthcare benefits issues. Finding those solutions will require frank discussions and compromise by **both** parties.

Unfortunately, the City's April 22, 2013 proposal raises serious concerns on a number of different levels about whether the City can engage in the kind of good faith negotiations needed to find real solutions to the difficult issues surrounding the retiree healthcare benefit.

1. **The City has incorrectly represented when full funding is effective under the retiree healthcare funding agreements.**

The fundamental premise of the City's April 22, 2013 proposal – as well as its earlier December 18, 2012 proposal on the same issue – has been the City's threat to begin full funding of retiree healthcare in June of this year. However, the City's implementation of full funding in June of this year would blatantly violate the retiree healthcare funding agreements entered into between the City and its bargaining units.

On April 21, 2009, the City Council approved the terms of retiree healthcare funding agreements with ABMEI, AEA, AMSP, CAMP, IBEW, MEF and CEO. Each of the healthcare funding agreements states that the transition to full funding would occur "over a period of five (5) years beginning June 28, 2009." With regard to the phasing in of full funding, each agreement states:

The phase in to the ARC [full funding] shall be divided into five steps (using a straight line method), each to be effective on the first pay period

of the City's fiscal year in each succeeding year. The first increment of the phase-in shall be effective on June 28, 2009. It is understood that because of changes resulting from future actuarial valuations, the amount of each increase may vary upward or downward. The City and Employee Organization agree that the Plan member cash contribution rate shall not have an incremental increase of more than .75% of pensionable pay in each fiscal year and the City cash contribution rate shall not have an incremental increase of more than .75% of pensionable pay in each fiscal year.

The City Council also approved implementing the above "phase in" for Executive Management and Professional Employees (Unit 99).¹ The City Council memorandum dated April 7, 2009 in support of the recommendation to approve the retiree healthcare funding agreements states that full funding would not occur until "the end of the five year phase-in."

Based on the above language, the "phase in" is to occur as follows:

Fiscal Year	Start Date	End Date	Maximum Increase
1	June 28, 2009	June 27, 2010	0.75%
2	June 28, 2010	June 27, 2011	0.75%
3	June 28, 2011	June 27, 2012	0.75%
4	June 28, 2012	June 27, 2013	0.75%
5	June 28, 2013	June 27, 2014	0.75%

Under the retiree healthcare funding agreements full funding clearly does not occur until June 28, 2014. Despite the clear language of the retiree healthcare funding agreements, the City has been making its most recent retirement healthcare proposals based on the incorrect representation that full funding occurs in June of this year.

The City has made this incorrect representation in negotiations with ALP. ALP and the City have agreed on all the provisions of an MOU except the provision regarding retirement healthcare. At the last negotiating session, ALP agreed to try to draft some

¹ At the time the City Council took this action, ALP had not yet been formed as a bargaining unit and its members at the time were part of Unit 99.

acceptable language for the provision. The City negotiators stated that any such language must reflect the City's implementation of full funding in June of this year.

The City's misstatements about when full funding becomes effective are troubling standing alone. These misstatements are even more troubling when considered in the context of recent anti-ALP statements made by the City. In a March 21, 2013 letter to the Mayor and City Council, ALP raised concerns about language contained in the Mayor's budget message that wrongly blamed the City's use of expensive outside legal counsel on ALP and then used that as an excuse to retaliate against ALP by recommending that "savings" from the City Attorney's Office be used to pay for outside attorneys. On March 26, 2013, the City Council adopted the Mayor's budget message with no discussion of these anti-ALP statements. Against this back drop, ALP is seriously concerned about whether the City will negotiate ALP's next MOU in good faith.²

In short, given that the parties are still in the transition period to full funding, there is no need for the City's April 22, 2013 retirement healthcare proposal.

2. The City wants employees to pay for a benefit without the City committing to what benefit it will provide.

In addition to the fact that the City's April 22, 2013 retiree healthcare proposal is unnecessary because another year remains in the 5-year transition to full funding, the proposal suffers from the same fundamental flaw as the City's earlier December 18, 2012 proposal: the City wants employees to negotiate how much they will pay for a benefit without clearly defining the benefit for which they are paying. This issue will need to be addressed in any future negotiations about the retiree healthcare benefit.

In relevant part, the 1975 Federated Employees Retirement Plan identifies the retiree healthcare benefit as being the City's payment of the portion of the premium:

... that represents an amount equivalent to the lowest of the premiums for single or family medical insurance coverage . . . which is available to an employee of the City at such time as said premium is due and owing.

In other words, the City pays retirees that portion of the medical plan premium that is equivalent to the premium for the lowest-priced medical plan available to City employees.³

² The MOU that ALP is currently negotiating would only be effective until June 30, 2013.

³ Under the 1975 Federated Employees Retirement Plan, an active employee with 15 or more years of service is entitled to receive the retiree healthcare benefit upon retirement. Accordingly, any rights discussed in this letter to which retirees are entitled apply equally to any City employee with 15 or more years of service.

Until this fiscal year, the Kaiser HMO plan had been the lowest cost medical plan, and the City's retiree healthcare benefit had been based on the cost of the Kaiser HMO plan. On several occasions, the City and employee bargaining units have negotiated and agreed on changes to the Kaiser HMO plan involving co-payments, but the Kaiser HMO plan had remained the lowest cost plan.

This fiscal year, **for the first time**, the City **unilaterally** implemented a new high-deductible medical plan with the goal of significantly reducing the cost of the retiree healthcare benefit.⁴ The new, high-deductible plan unilaterally implemented by the City has a significantly lower premium. However, the City's unilateral action has resulted in retirees unexpectedly having to pay hundreds of dollars more each month to continue the same healthcare coverage under their retiree healthcare benefit.

ALP's concern has been that the City would continue down the road of eroding the retiree healthcare benefit by unilaterally implementing less desirable medical insurance in its quest to lower premium costs. The City's April 22, 2013 proposal confirms ALP's concern by threatening to unilaterally implement yet another even higher deductible healthcare plan with an even lower premium. The City apparently now interprets the retiree healthcare benefit language as allowing it to unilaterally implement a cheaper healthcare plan whenever it wants to save money by making the retirees pay more for the benefit. The City apparently believes its authority is without limitation, restriction or regard to the "consideration" paid by active City employees and retirees.

The City's recent interpretation of the retiree healthcare benefit language is seriously flawed. Based on the advice of outside legal counsel, the City has publicly conceded that the retiree healthcare benefit is a "vested" right. In California, "vested" rights are analyzed under contract principles.

The City's interpretation of the retiree healthcare benefit language would result in an improper "illusory" promise. An "illusory" promise occurs when someone appears to promise something but in reality has a choice to perform or not perform. The City's interpretation of the retiree healthcare benefit language results in an "illusory" promise because it ultimately would give the City unfettered discretion to at any time reduce the

⁴ For **active** employees, the City continues to pay 85% of the premium for the Kaiser HMO plan.

retiree healthcare benefit provided to retirees. Such an interpretation improperly impairs the vested rights of active City employees and retirees.⁵

A person would be foolhardy to negotiate the payments on a car without knowing the kind of car he/she is buying. Yet, this is exactly what the City is asking active City employees to do. The City is taking the unreasonable position of asking active City employees to negotiate paying for a retiree healthcare benefit without any real promise from the City as to what benefit, if any, it will provide. Both the City's December, 2012 proposal and its most recent one completely ignore this problem.

3. **It is inequitable for the City to take compensation earned by active employees to pay obligations the City has to its retirees.**

The problem discussed under the second heading is exacerbated by the fact that active City employees are already significantly overpaying for whatever retiree healthcare benefit the City decides to provide them with at retirement. ***ALP members have been, and continue to be, ready and willing to pay for their 50% of the cost of the retiree healthcare benefit that they will actually receive.*** But this is not the discussion that the City is having with its active employees.

The retiree healthcare benefit was established in the mid 1980s. Although not identified at the time, an unfunded liability was created almost instantly. This is because people immediately became eligible for the benefit even though they had not contributed anything to pay for the benefit. Moreover, rather than fully fund the benefit, ongoing contributions were based on an actuarially determined percentage of employees' base salary sufficient to provide adequate money to pay the benefit when due over a 15-year period. This significantly contributed to an ever increasing, unidentified, unfunded liability.

In fiscal year 2008 the City implemented new accounting methods that for the first time identified the unfunded actuarial liability that had accrued. The current outstanding amount of the unfunded liability is \$749,027,093. Under the new accounting methods this unfunded liability is being amortized (paid off) over 30 years.

Significantly, much of the unfunded liability is not attributable to active employees. At the coalition meeting on April 17, 2013, you provided information indicating that less than one-half of what is deducted from the paycheck of active employees for this benefit

⁵ Moreover, the City's recent interpretation of the retiree healthcare benefit completely ignores the implied promises that the City made to active employees and retirees regarding what constitutes the lowest cost healthcare plan. See, *Retired Employees Association of Orange County vs. Orange County*, in which the California Supreme Court unanimously concluded that a government can not eliminate health benefits for retirees if the government expressly or impliedly promised benefits as part of the employment agreement.

actually goes towards the benefit they will receive⁶ and the remainder pays for the benefit for retirees and for the unfunded liability not attributable to active employees.

Simply put, the City promised to provide a benefit to retirees and then failed to provide appropriate funding for that benefit. To remedy that lack of planning, the City takes a portion of the compensation earned by **active** employees and uses it to pay for its obligation to retirees and past unfunded liability obligations that have accumulated. And now, as discussed more below, the City wants to leave current, active employees "holding the bag" by completely closing the plan to new employees. The City's position is utterly inequitable.⁷

4. **Closing the current plan to new employees without having an overall resolution of the retiree healthcare issues is irresponsible.**

Like the City's December 2012 proposal, the City's most recent proposal would close the plan to new employees, resulting in new employees not paying anything towards the existing unfunded liability or the benefits of retirees. ALP has expressed concern over what impact this would have on the existing retiree healthcare plan. In response to this concern, the City's most recent proposal offers to pay what new employees and the City would have contributed towards the existing unfunded liability **for a single year**.

The City retained the actuarial firm of Bartel and Associates to determine the potential impact to future contribution rates if the current retiree healthcare plan were closed to new employees.⁸ Bartel and Associates projected that in 20 years contributions could reach a staggering 164% (82% for the City and 82% for employees). Given these projections, the City's offer to pay for one year of contributions is obviously a token gesture that falls extraordinarily short of addressing concerns about closing the plan to new employees. Moreover, these projections demonstrate that, while closing the plan to new employees might be part of **a carefully analyzed global resolution of retiree healthcare benefit issues**, there is no reasonable basis for the piecemeal approach being taken by the City. Indeed, such an approach is irresponsible.

⁶ In light of the City's interpretation of the retiree healthcare benefit discussed under heading two even this may be overly generous given the City's apparent desire to continue to erode the benefit.

⁷ ALP completely disagrees with the statement in your letter that "[w]e both have acknowledged that, even with this significant reduction, the costs for employees and the City are still too high." This suggests we are in agreement as to the reasons the costs are too high. We are not!

⁸ During negotiations with the City over the City's December 18, 2012 proposal, ALP requested information about any analysis done by the City regarding closing the plan to new employees. The City never gave ALP any information. ALP became aware of the City's analysis when reviewing public records as part of a bond issuance being undertaken by the City this month.

Your letter indicates that the City wants to close the plan to new employees because:

... we believe that it is important to not require new employees to belong to a plan with such a high cost to the employee for a benefit that will likely have little value since they will be in Tier 2 with a retirement age of 65.

In light of the analysis by Bartel and Associates, along with the City's desire to continue on the path of providing an ever cheaper medical plan, closing the plan to new employees results in the same concern for active employees: that active employees will belong to a plan with such a high cost to the employee for a benefit that will likely have significantly less value than the amount contributed. The City should demonstrate at least the same level of concern for its active employees – many of whom have dedicated their careers to public service – as it does for some unspecified, future employee.

5. The 4-tier rate structure for health benefits is illegal.

As with the City's December proposal, the City's most recent proposal threatens to implement a four tier rate program for both active employees and retirees for health and dental benefits. As with closing the plan to new employees, ALP does not oppose the concept **as part of a carefully analyzed global resolution of retiree healthcare benefit issues**. However, the City's piecemeal approach is unacceptable and irresponsible.

First, implementing the 4-tier rate program as to retirees is blatantly illegal. The plain language of the 1975 Federated Employees Retirement Plan states that the retiree healthcare benefit is the payment of the portion of the premium "that represents an amount equivalent to the lowest of the premiums **for single or family medical insurance coverage**. . . . (Emphasis added.) The vested right **expressly** created by this language is a premium based on "single or family medical insurance coverage."

Second, the City apparently has not done an analysis of the impact of implementing the 4-tier rate program on active employees and/or retirees. Other than providing ALP with what the new rates would be, the City has not provide ALP with any analysis of cost savings, if any, for the City and/or it employees.

Third, the proposal is a particularly harsh anti-family measure when considered in context. The rates for active employees to obtain healthcare coverage for a spouse and children will go up significantly. This additional cost to families is on top of the recent 10% cut in compensation, the proposed increase in retirement contributions under Measure B, and the threat of increasing contributions to the retiree healthcare benefit. These additional costs could be crushing for many families and need to be discussed as part of a global resolution of various issues.

6. The City's actions violate the phase-in provision of the retiree healthcare funding agreements.

As discussed under heading one above, the City's implementation of full funding this June would violate the express language of the retiree healthcare funding agreements. In addition, the City's recent actions seriously threaten the material assumptions underlying the agreement of the bargaining units to a minimum 5-year phase-in period.

The City Council memorandum dated April 7, 2009 in support of the recommendation to approve the retiree healthcare funding agreements states that the agreements were based on "the adoption of a reasonable ramp-up period, i.e., one not less than five years, to reach full funding. . . ." The parties agreed to the *minimum* amount of time considered to be "a reasonable ramp-up period."

Since the approval of the retiree healthcare funding agreements, the assumptions underlying what constitutes a reasonable ramp-up period have changed materially. These material changes include the following:

- The amount of the contributions needed to fully fund the retirement healthcare benefit far exceed what anyone reasonably could have contemplated at the time the minimum 5-year transition period was negotiated.
- At the time the employees negotiated the phase-in agreement, the Kaiser HMO was, and had been, the lowest cost medical insurance coverage available to an employee. There was no indication that would change. Subsequent to entering into the agreements, the City unilaterally implemented a low cost, high deductible plan.
- At the time the employees negotiated the full funding agreement, the retiree healthcare benefit premiums were based on single or family medical insurance coverage rates. Although these rates continue to be valid at this moment, the City is threatening to implement a 4-tier rate program for retirees.
- As discussed above, the City is threatening to close the plan to new employees, which will have a significant impact on the plan.

In light of the above, what constituted a "reasonable ramp up period" when the retiree healthcare funding agreements were negotiated, no longer constitutes a reasonable ramp up period. Under current circumstances, a reasonable ramp-up period is significantly longer than the 5-years agreed to over 4 years ago.

7. **Conclusion.**

In light of the fact that full funding does not occur for another year, there is no need for the City's April 22, 2013 proposal on retiree healthcare. The parties should continue to negotiate a permanent resolution of the retiree healthcare benefit issues during this time. On this note, ALP has some ideas about a permanent resolution to the retiree healthcare benefit issues for active employees and would like to meet with you to discuss whether the City would be interested in ***jointly pursuing these ideas***. ALP believes these ideas could eliminate the need to deal with "lowest cost plans" and the tiering of benefit rates.

We look forward to your response.

Very truly yours,

ASSOCIATION OF LEGAL PROFESSIONALS



VERA M. I. TODOROV
President

Mayor and Council Members
Chair and Members of Federated Retirement Board
Debra Figone
Rick Doyle
Harvey Leiderman
Jennifer Schembri
Marco Mercado
Gary Messing
Charles Sakai

