

M E D I C A R E

Retiree Health VEBAs: A New Twist On An Old Paradigm Implications for Retirees, Unions and Employers

Prepared By:

Phyllis C. Borzi, J.D., M.A.
Research Professor
The George Washington University
School of Public Health and Health Services
Department of Health Policy

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Phyllis C. Borzi¹

Executive Summary

Employers have been using traditional trusts called VEBAs (voluntary employees' beneficiary associations) for decades to put aside money to pay medical and other benefits for their employees as a hedge against future payment difficulties. But as health care costs have continued to escalate and businesses have faced growing economic challenges, many employers are rethinking their long-term health care promises to retirees. As part of this transformation, the traditional VEBA has taken on a different character and a new form of VEBA has emerged: the so-called "stand-alone" VEBA trust, through which some employers have been able to rid themselves of future obligations to pay retiree health benefits in exchange for making a significant payment to the VEBA designed to approximate the total projected cost of the benefits.

The purpose of this issue brief is to discuss several key questions in connection with the current use of stand-alone VEBAs. The paper profiles three VEBAs through case studies, draws preliminary conclusions from their early experiences, and considers the implications and future questions raised by this approach to providing retiree medical benefits.

The most common situations in which stand-alone VEBAs have been used in this fashion are: (1) as part of a negotiated settlement of outstanding liabilities when the employer is in bankruptcy; (2) as a result of collective bargaining when an employer in financial difficulty proposes a major restructuring of its health benefit obligations as an alternative to bankruptcy; or (3) as a method of settling a class action suit brought by retirees, a union, or both, to block termination or modification of retiree medical benefits.

The recent interest in VEBAs among large employers is not hard to fathom. Escalation of health care costs is clearly an important factor, but employer interest in VEBAs arises primarily from changes in corporate accounting rules that require public companies to adopt more prominent balance sheet disclosure of their retiree health liabilities.

For employers, VEBAs have the potential to yield an immediate two-fold benefit. Not only can the company shed any future legal liability for paying promised benefits to retirees, but it also can terminate any balance sheet liability attributable to those obligations.

¹ J.D., M.A., Research Professor, Department of Health Policy, School of Public Health and Health Services, The George Washington University Medical Center and Of Counsel, O'Donoghue & O'Donoghue LLP, Washington, DC,

For retirees, however, the consequences of such a transaction are far less certain. On the one hand, VEBAs offer retirees a dedicated source of funding for future medical benefits, so receipt of benefits is no longer entirely contingent on their employer's continued existence, financial health and good will. On the other hand, VEBAs do not guarantee that promised benefits will be fully funded since the existence and affordability of benefits in the future is limited to what the assets in the VEBA will ultimately support. Moreover, to the extent that employer stock has been contributed to the VEBA instead of or in addition to cash (as is being currently proposed for the auto industry VEBAs), in the current troubled economic climate, the VEBA's asset base may be even less secure than originally projected. Although retirees may view the VEBA alternative as merely trading one set of uncertainties for another, this new generation of VEBAs may be the best hope some retirees have for retaining employer-sponsored medical benefits either as primary coverage for early retirees or supplementary coverage for Medicare-eligible retirees.

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Background

The uncertainty that many Americans feel about whether their health insurance will be there when they need it continues to grow. Over time, it has become increasingly apparent that those with employer-sponsored health insurance plans can lose that coverage overnight if their job situation changes – they lose full-time status, become disabled, are laid-off or terminated, change jobs voluntarily, or leave the workforce for child-rearing or other caregiving reasons. Or, they may lose their coverage if their company makes a change, for example, if it fails, is bought out by another entity, or if the employer decides to discontinue its health plan for any reason. For spouses and dependents whose access to health insurance flows from their relationship to the employee, the situation is even more tenuous.

Perhaps no group of individuals with employer-sponsored health insurance is more endangered than retirees, as retiree medical coverage has sharply declined over the past two decades.¹ Although the number of employers canceling their plans seems to have stabilized recently, substantial cost-shifting continues. According to the most recent Kaiser/Hewitt Associates Retiree Health Survey, in 2006, 74% of employers increased retiree premiums, 32% increased retiree drug co-payments or co-insurance, 25% increased retiree out-of-pocket limits, and 11% eliminated subsidized retiree health benefits entirely for new hires.² Many employers also made significant changes in the design of their health plans for retirees, capping company contributions or moving to account-based approaches rather than retaining the more traditional health plan structure familiar to most retirees.³

Unquestionably this trend toward eroding retiree medical coverage has been driven in large part by the escalating costs faced by employers that voluntarily provide health benefits and the challenge of global competition. But equally important in understanding these downward trends for retirees is the effect that the changes in corporate accounting treatment for retiree benefits that have been imposed since 1990 have had on employers' willingness and ability to continue to provide the benefits that retirees were promised and fully expected to receive. Particularly for employers now facing global competitors that do not have these ongoing fiscal responsibilities to retirees, the pressures to reduce their so-called "legacy costs" have been enormous. Unfortunately some employers have chosen to respond to these pressures in ways that have resulted in severe financial hardship and cutbacks in access to health insurance for retirees facing medical crises.⁴

Recently an interesting approach in the evolution of retiree medical benefits has emerged: the use of stand-alone tax-favored trusts (voluntary employees' beneficiary associations or VEBAs) as mechanisms to transition responsibility for paying those ongoing benefits from employer-sponsored retiree benefit plans to independent private sector tax-exempt entities.

The purpose of this issue brief is to discuss several key questions in connection with the current use of stand-alone VEBAs, to profile three recent VEBAs through case studies, and to consider the implications and future questions raised by this new approach to providing retiree medical benefits.

What is a VEBA?

A voluntary employees' beneficiary association or VEBA is a tax-exempt organization that can be used as a funding vehicle for retiree medical and certain other types of benefits. Eligible for tax-exempt treatment under Section 501(c)(9) of the Internal Revenue Code, VEBAs usually are set up as trusts, but they can also be organized as corporations or associations. VEBAs can be used to pay life, sickness, accident and similar benefits to members of the association and their dependents, if the VEBA meets certain specified requirements under the Code.

For instance, a VEBA must be a voluntary association of employees or former employees who have an employment-related common bond. This bond can be demonstrated by connection among members through an employer or former employer, coverage under one or more collective bargaining agreements, or membership in a labor union or one or more locals of a national or international union. According to the IRS, during fiscal year 2007, more than 12,000 tax returns were filed on behalf of VEBAs, although there is no way to determine with certainty what types of benefits were provided under these trusts.⁵ Nor is there a way to determine how many of them are stand-alone VEBAs not established or maintained by employers as a mechanism to fund their ongoing health care plans.

First introduced into the tax law in 1928,⁶ VEBAs can be established by employers or by groups of employees, but they must be controlled by their members or by an independent trustee or trustees, at least some of whom are designated by the members. Funds held by the VEBA and earnings on those assets are not taxable, but the benefits paid may or may not be taxable to the recipient, depending on the type of benefits.

Unlike pension plans, which under the Employee Retirement Income Security Act of 1974 (ERISA) are required to be funded in advance, health benefits are ordinarily payable from the general assets of the employer since, except when health benefits are collectively bargained, the tax code prohibits prefunding. Although employer contributions to a VEBA for current health benefits are deductible, the significant limitations on deductibility of employer contributions for future health benefits have been the primary reason that VEBAs are not more widely used by employers. The main problem is that the annual deductible for plan sponsors is limited to the expected amount necessary to fund that year's incurred but unpaid claims, plus administrative expenses.⁷ So any attempt by employers to set aside money in advance on a tax-favored basis to pay future health benefits is likely to be prohibited.

But there are two important exceptions to these limits. When contributions to a health plan are made pursuant to a collective bargaining agreement, they are fully deductible when made to a VEBA.⁸ In addition, a full deduction can be taken for annual contributions made on behalf of employees (whether or not unionized) to fund a reserve, as long as (1) the reserve is funded over the working lives of the covered employees and (2) the annual contributions necessary to fund post-retirement medical or life insurance benefits are actuarially determined on a level basis.⁹ Not surprisingly, given these restrictions, VEBAs designed to pay ongoing health benefits for active and retired workers are typically more likely to be found in industries where benefits are collectively bargained.¹⁰

In addition to tax code requirements, VEBAs may also be subject to other legal requirements depending on how they are established and what benefits are provided through this funding vehicle. For instance, when the VEBA is collectively bargained, the federal Taft-Hartley requirements may apply.¹¹ In addition, many VEBAs are “employee welfare benefit plans” under the Employee Retirement Income Security Act of 1974 (ERISA) and therefore subject to the ERISA rules¹² as well as the tax code requirements. Fully insured VEBAs may also be indirectly subject to state law as well.

How Are VEBAs Used?

In most cases, VEBAs have been used by employers to segregate assets to pay ongoing health benefits for active workers or retirees from the company’s general assets. The employer retains control over the funding and administration of the VEBA because it is used simply as a funding vehicle for the employer-sponsored plan.

“Stand-alone VEBAs” differ from traditional VEBAs in that they are generally designed to operate somewhat or fully independently of the employer for whom the retirees performed services when they were active employees. This new generation of VEBAs has been established most frequently as part of a negotiated settlement of outstanding liabilities when the employer is in bankruptcy, as a result of collective bargaining when an employer in financial difficulty proposes a major restructuring of its health benefit obligations as an alternative to bankruptcy, or as a method of settling a class action suit brought by retirees, a union, or both to block termination or modification of their retiree medical benefits.

Bankruptcy

Historically, most stand-alone VEBAs have been an outgrowth of employer bankruptcies. According to a 2007 survey of 25 retiree health VEBAs conducted by the Segal Company, more than half of these VEBAs were created as a result of bankruptcy – ten were formed in bankruptcy with an additional seven resulting from collective bargaining in bankruptcy.¹³

Federal bankruptcy law allows employers to terminate or modify their existing health benefit programs for active employees even if that would violate an existing collective bargaining agreement, as long as the bankruptcy court approves.¹⁴ A separate procedure allows employers in bankruptcy to negotiate modifications of retiree health obligations.¹⁵ For instance, the debtor cannot unilaterally terminate or modify the retiree medical plan after the bankruptcy filing. Instead, the bankruptcy court will appoint a committee of retirees to negotiate with the debtor. The debtor proposes modifications “necessary to permit reorganization” of the company and then must negotiate with the retiree committee. If no agreement is reached, the court can order modification of the plan, but the retirees are entitled to a “general unsecured claim” in bankruptcy for the value of the benefits that have been eliminated. This type of a claim puts the retirees at the end of the line after other higher priority creditors in bankruptcy. As a practical matter, this means that the retirees will get little or nothing to compensate them for their loss. As an alternative, retirees sometimes agree to allow the employer to set up a stand-alone VEBA and contribute a specified sum to settle the retiree claims in bankruptcy.

Companies that have established stand-alone VBAs as a result of recent settlements of retiree obligations in Chapter 11 bankruptcy reorganizations include Dana Corporation,¹⁶ based in Toledo, Ohio, which agreed to set up three VBAs – one for the salaried retirees and two for the hourly retiree employees, one for those represented by the Autoworkers union and another for those represented by the Steelworkers union.¹⁷ (See Case Study #1) Tower Automotive also promised to make a series of cash payments to three different VBAs, each negotiated with the respective unions representing separate groups of retirees.¹⁸..

Collective Bargaining Outside of Bankruptcy

The United Auto Workers and the Big Three automobile companies (General Motors, Ford and Chrysler) have been in the news lately because they have recently negotiated additional and much larger VBAs to supplement the existing VBAs that were negotiated in 2005 with GM and Ford¹⁹ and approved by the courts in 2006.

The 2005 VBAs were designed to mitigate some of the new out-of-pocket costs for retirees that resulted under the new more modest retiree medical plan negotiated with the union for which GM had agreed to retain liability for providing retiree benefits in that round of collective bargaining.²⁰ A similar arrangement was negotiated with Ford.²¹ In the 2005 round of bargaining, the auto companies agreed to continue their retiree medical plans but were allowed to drop dental coverage and, for the first time, impose certain co-payments and deductibles. The 2005 VBAs were designed to assist retirees in offsetting these reductions in coverage. In exchange for this modification in coverage for retirees, the companies agreed to contribute to the VBA. Employer contributions are also supplemented with contributions by active workers, primarily wage and cost-of-living adjustment deferrals. Both the GM and Ford 2005 VBAs are governed by boards of trustees independent of the company.

To fund its part of the 2005 VEBA, GM agreed to contribute a minimum of \$3 billion: \$1 billion in 2006, \$1 billion in 2007 and \$1 billion in 2011 (or earlier if the assets fall below a specified amount).²² Additional cash contributions based on the increase in value of certain GM stock were also required.²³

To fund its 2005 VEBA, Ford agreed to contribute \$108 million over several years, with an acceleration clause if the balance in the VEBA falls below a certain level.²⁴ Additional Ford contributions based on appreciation of certain Ford stock were also required.²⁵

In contrast, the agreement negotiated in the fall of 2007 between the UAW and all three auto companies allows the firms to transfer their retiree health liabilities to a new stand-alone VEBA. A single administrative structure has been created with a single VEBA Board of Trustees, but each of the retiree auto company groups will have its own separate plan and separate subaccount within the VEBA trust.²⁶ The total funding agreed to by the three companies is \$56.4 billion²⁷ and an independent board will oversee the VEBAs. How these negotiated funding arrangements will be affected by the recent financial loan plan for the auto companies approved by the Bush Administration in December, 2008 remains to be seen.²⁸ (See Case Study # 2.)

Settlement of Retiree Class Action Litigation

To the extent they have reserved the right to do so in their plan documents using so-called “reservation of rights clauses,” employers generally believe they have the legal right to terminate or modify their retiree health promises at any time since ERISA’s statutory vesting rules only apply to pension plans.²⁹ In evaluating this claim by employers, a court will determine whether there is any non-statutory basis for finding that the benefits have “vested.” In asserting a vesting claim for retiree health benefits, non-union or management retirees typically fare worse in the courts than union retirees, since most courts that have found the retirees have a vested right to health benefits have done so on the basis of enforcing the terms of a contractual agreement that confers vested status on retirees.³⁰

Nevertheless, when an employer announces plans to terminate or modify its retiree health plan, retirees often threaten to file a class action lawsuit to prevent this action. On the one hand, the employer asserts its legal right to change or eliminate the plan based on the reservation of rights clause; on the other hand, retirees assert they have a legal right to lifetime benefits because they were promised that if they worked until retirement, they were guaranteed health benefits for life. The retirees argue that they have fulfilled their part of the bargain and now the employer must keep its word. When the employer moves forward to implement its decision, retirees may file suit, often joined by the union.³¹

In a number of cases, settlement of the ensuing class action lawsuit has involved the establishment of a stand-alone VEBA, with an agreement on the part of the employer to contribute a fixed cash amount (in one or more payments) to fund the VEBA (sometimes supplemented with a contribution of employer stock) which will then take over the job of providing retiree medical benefits. In essence, the employer is able to

strike a deal offloading some or all of its future retiree benefit liability in exchange for making a lump sum contribution to a trust dedicated solely to pay for benefits that are completely divorced from the employer's management and control. If a union is also involved in the class action lawsuit, the settlement agreement usually contains provisions specifying that the union agrees not to bargain over retiree benefits in the future. Often the settlement agreement will also provide that active workers may agree to defer some or all of future wage increases or cost-of-living adjustments as an additional funding stream for the VEBA.

Recent examples of this approach include the settlement agreement between Goodyear Tire and Rubber Co., a class of Steelworker retirees, and the United Steelworkers Union³² and the settlement agreement approved in early 2008 between the AK Steel Company and a class of retirees who had worked in the company's Middletown, Ohio facility under collective bargaining agreements between the company and the Armco Employees Independent Federation, Inc. (AEIF).³³ (See Case Study #3).

What is Driving the Recent VEBA Activity?

Employer Considerations

The recent interest in VEBAs among large employers is not hard to fathom. Although continuing escalation of health care costs is important, employer interest in VEBAs arises primarily from the marketplace effect on these employers that has occurred as a result of changes in corporate accounting rules forcing public companies to adopt more prominent balance sheet disclosure of the existence and magnitude of their retiree health liabilities.

In 1990, the Financial Accounting Standard Board (FASB) released an accounting standard (FAS 106) that changed the way that publicly held companies were required to account for future costs of other post-employment benefits (OPEB), including retiree health and life insurance. Established in 1974, FASB is the private sector organization to which the Securities and Exchange Commission has delegated standard-setting authority for financial accounting and reporting. What the FASB decreed was that for fiscal years beginning after December 15, 1992, public companies could no longer bury their retiree medical liabilities in the footnotes of their financial disclosure forms or report their obligations on a pay-as-you go basis. Instead, these companies would have to report an accrued liability on their financial statements equal to the value of their OPEB liability, a measure designed to acknowledge these costs in a more tangible way. The employer's OPEB liability could be offset on the balance sheet with any existing assets that had been segregated to defray those liabilities.³⁴

Minimizing their accounting liabilities or moving retiree health liabilities off their balance sheets entirely is a major concern for these employers. For instance, the Big Three auto companies reportedly had a combined projected retiree medical liabilities total of \$100 billion in 2006 and the companies claim that providing health insurance for active employees and retirees adds about \$1,500 to the cost of each car they sell.³⁵

From an employer point of view, establishing a stand-alone VEBA and negotiating with the union and/or retirees to transfer future retiree medical liabilities to the VEBA in exchange for a specified cash contribution (usually calculated with relation to the employer's reported OPEB accounting liability) provides a number of significant advantages.

Perhaps the most significant advantage is that not only can the employer eliminate a significant ongoing cash flow obligation, but the employer is also able to erase its balance sheet accounting liability for the retiree benefits. To the extent that the cash contribution made to a VEBA satisfying the employer's future obligations to provide retiree medical benefits can be construed under the accounting rules to be a "settlement" or elimination of the employer's OPEB for the benefits, the employer gains an immediate and often substantial improvement in its balance sheet position. This clearly will be a big advantage for the employer with current shareholders and potential investors. Moreover, the employer also gains because it is able to eliminate future potential legal and public relations problems it might have faced for any subsequent modifications or reductions in retiree medical benefits it might have adopted.

The primary downside consideration for employers contemplating the negotiation and establishment of a stand-alone VEBA is the often lengthy and complicated process that ensues even after the negotiations setting the terms for the VEBA are successfully concluded.

Various judicial and government approvals will be necessary. If a settlement agreement has to be approved by a court, affected participants and/or class members will have to be notified and given an opportunity to object to the settlement in writing. The judge will also conduct a "Fairness Hearing" in which class members other than the named plaintiffs will be able to testify in support of or in opposition to the proposed settlement agreement.

After listening to all the evidence and reviewing the proposed settlement agreement, the judge will have to determine whether the settlement agreement is fair, reasonable and adequate and, in doing so, will have to make findings on the record about several important factors. In the AK Steel case, for instance, the judge considered a number of things, including (1) the likelihood of the plaintiff's success on the merits; (2) the complexity, expense and likely duration of the litigation if the case was tried, (3) the opinions of class counsel and class representatives, (4) the reaction of absent class members, and (5) the public interest.³⁶

The time that elapses between the signing of the proposed settlement agreement and its final approval can vary considerably. In the Goodyear case, the settlement agreement was signed by the parties on October 29, 2007, the Fairness Hearing was held on April 17, 2008 and the settlement agreement was finally approved by the district court on August 22, 2008, but only after the court had requested additional briefing and arguments focusing in part on the reliability of the actuarial projections of how long the

assets contributed by Goodyear were expected to last to pay benefits. On the other hand, in the AK Steel case, the settlement agreement was signed in October, 2007 and the court gave final approval to the settlement on February 21, 2008.

Further delay can occur if the agreed upon employer contribution to the VEBA includes employer stock or other employer securities, since both ERISA and the tax code prohibit this type of a transaction unless certain conditions are met.³⁷ Thus the VEBA will have to seek an administrative exemption from ERISA's prohibited transaction rules from the U.S. Department of Labor in order to acquire and hold the stock.³⁸

In the end, the clear winner when a stand-alone VEBA is established to pay future retiree health benefits is likely to be the employer because the transaction allows the employer to terminate both the legal liability for its retiree medical benefits and the accounting obligations associated with that liability.

Retiree Considerations

When a group of retirees believes it has a legal right to lifetime health benefits and files a class action lawsuit to stop their employer from terminating or substantially reducing their health benefits, they are not likely to be completely satisfied by a settlement of that litigation that allows their employer to walk away from future liabilities for retiree medical benefits, even after paying a considerable amount of money to do so. This is particularly true since under the existing settlements, financially troubled employers often pay the VEBA less than the full projected amount that the future retiree benefits would cost.

Why retirees would agree to let the employer off the hook is a relevant question to address. Even though agreeing to the establishment of a stand-alone VEBA which will assume the responsibility of paying retiree benefits in the future is hardly a risk-free proposition, it does have some positive features.

First, the transaction eliminates the risk that the company will be able to abrogate its retiree liabilities entirely in bankruptcy. In most of the situations in which stand-alone VEBAs have been established, there is a real risk that the employer could face bankruptcy in the future. At the very least, the company's future financial status is likely to be uncertain.

Another key factor for retirees is that the assets the employer has contributed to the VEBA will be permanently shielded from the reach of the employer's creditors should an employer bankruptcy occur in the future. Since the current source of funding for most retiree medical benefits is the employer's general assets, establishing a VEBA creates a stable and protected, though limited, source of assets to pay benefits.

Further, no longer will the employer control benefit design changes or be able to shift costs to retirees. In fact, under some VEBA governance structures, retirees may have a say in future benefit changes themselves. Based on the way that the stand alone VBAs have generally been set up, the need for future benefit changes will be decided by committees of individuals independent of their former employer whose duty of loyalty to retirees and commitment to keep the VEBA solvent will be the only drivers of their decisions.³⁹

But, as previously noted, VBAs are not a panacea for retirees. Many of these trusts start out underfunded. If employers are in financial difficulty, the parties may agree to accept an amount in required employer contributions that they know even at the outset may not be sufficient to fully cover projected liabilities. In addition, to the extent that the employer contribution consists of employer stock or other employer securities, given the current economic downturn, the VEBA may find that those assets are far less valuable than originally projected. So there is clearly a risk that the VEBA may run out of money before all retiree liabilities are satisfied or before all early retirees are eligible for Medicare.⁴⁰ The nature and timing of contributions is critical. This is a particular worry if the only source of contribution is a one-time payment by the employer with no supplemental payments or no ongoing source of assets to pay benefits if times get tough.

Moreover, because the time horizon for the VEBA's payment obligations may be difficult to predict, investments may have to be more aggressively managed than traditional pension plans do because a VEBA's cash flow needs are quite different. So it is important to select investment advisors who understand the liquidity needs of a VEBA and can devise an investment strategy that will match performance with fiscal reality. Thinking and worrying about these issues may be a new experience for retirees, especially those who might now sit on the committee charged with oversight of the VEBA.

And of course, VBAs are no more immune than other health plans from the uncertainty of future medical costs, so the risk of guessing wrong on the effect of medical inflation on plan costs is enormous.

The bottom line for retirees who settle their lawsuits by agreeing to a stand-alone VEBA is that while they may be better off by exchanging a totally unfunded employer benefit promise for a funded trust, secure even through an employer bankruptcy, as a practical matter, they may simply be replacing one set of uncertainties for another.

Union Considerations

Maintaining and strengthening health insurance coverage for active workers and retirees has been one of labor's most difficult challenges in the past decade. Although retiree benefits are not a mandatory subject of bargaining under the National Labor Relations Act, for many labor unions preserving retiree benefits has been the linchpin of their ability to maintain generational solidarity among their members and an important way to demonstrate the value of union membership. But success at the bargaining table is not easily achieved and always comes at a price.

For the union, then, the appeal of allowing an employer to terminate its existing legal obligation for retiree health benefits and shift its liability to a stand-alone VEBA, even one in which the union may be able to exercise a greater degree of control than before over benefits, may not be immediately obvious. Perhaps not surprisingly, some unions have rather reluctantly and somewhat belatedly (at least compared to employers) been willing to agree to these arrangements.

Removing one of the most contentious issues from future bargaining sessions has some appeal for unions, but the tradeoffs and consequences of such a deal can be enormous. Even if the union is not technically responsible for running the VEBA because the governing structure entrusts that legal obligation to a committee or board on which representatives of the union may serve (but may not control), the retirees will look to the union, and potentially blame the union, if problems occur.

Still, some unions are willing to take the risk because they believe that the marketplace challenges for employers are such that the only way they can assure that retirees will continue to enjoy health benefits similar to those they have had in the past is to assume the responsibility either by directly running the VEBA themselves or indirectly entrusting the retirees' future benefits to a board or committee of carefully selected independent experts who will share the union's view that the retirees must be protected.

The bottom line for the unions is there may be no other way to maintain the hard-fought retiree health benefits they have been able to negotiate than to work with employers to find a new and different way to assure these promises will be kept.

VEBA Governance: A Critical Element

One feature of the new generation of stand-alone VEBAs that distinguishes them from the VEBAs of the past is their governance structure.

As previously noted, some employers use VEBA trusts to fund ongoing medical costs. Multiemployer health and welfare plans also use VEBAs to fund their ongoing health benefits. In each case, the plan sponsor governs the plan and its administration. Even in the case of a multiemployer plan where the Taft-Hartley Act requires the plan to be governed by a board of trustees with equal representation of labor and management and the board is considered the plan sponsor under ERISA, governance typically is internal to the union and the sponsoring employers.

In contrast, when the plan sponsor intends to transfer its retiree medical liabilities to the VEBA, in order to be able to show that it has terminated any future legal liability for paying benefits and future accounting liability for the obligations those benefits represent, the plan sponsor must make a clean break from any maintenance or administration of future benefits. If the employer continues to be involved on the governing board of the new VEBA, arguably termination of legal and accounting liability has not occurred. Therefore, most stand-alone VEBAs are likely to have no employer involvement in their governance structure.

Although it is difficult to determine how many stand-alone VEBAs exist based on publicly available data, some limited information is available that may shed light on the governance structure of a sample of them.

According to a recent study of 25 stand-alone retiree health VEBAs by the Segal Company, the composition of the boards of trustees or administrative committees running the VEBAs varies considerably.⁴¹ Not surprisingly, the study reported that most governing boards have no company representatives at all. Just one of the 25 VEBAs in the Segal study has solely company trustees. Five VEBAs have both union and company trustees (the classic structure of multiemployer plans). Seven of the surveyed VEBAs have only retiree trustees, six have boards of retiree and union trustees and four have retiree, union and independent trustees. Two have boards with only union and independent trustees.⁴² Although nearly half of the VEBAs in the study were small (i.e., fewer than 5,000 participants), six had more than 10,000 participants and two had more than 100,000 participants.⁴³

Public Sector VEBAs

Although less common than their private sector counterparts, VEBAs and other trusts have begun to take on importance as state and local governments grapple with new accounting standards issued by the Government Accounting Standards Board (GASB) in 2004. GASB is a sister agency to the Financial Accounting Standards Board and its 2004 Standard 45 changed the way that public entities must account for their other post-employment benefits (OPEB) liabilities in a manner similar to the standards applicable to private sector employers. These liabilities can include the costs of retiree health, dental, vision care and life insurance benefits. OPEB liability must be actuarially calculated and accrued during the working life of employees, recognized as a financial obligation and then reported on the governmental employers' financial statements.

To offset OPEB liabilities, state and local governments may prefund benefits using a variety of tools.⁴⁴ These can include VEBAs, government trusts established under Section 115 of the Internal Revenue Code, and Section 401(h) accounts within a defined benefit pension plan (this latter option is also available to private sector employers). Some state and local governments have the authority to issue bonds (either general obligation (GO) bonds or Certificate of Participation (COP) bonds). Under GASB Statement 45, these bonds may also be used to offset OPEB liability.

In the public sector, some VEBAs have been funded with contributions representing the proceeds of unused accrued sick leave.⁴⁵ More recently, however, governments have set up central trusts under Section 115 of the Internal Revenue Code into which contributions for retiree medical benefits are made on an irrevocable basis. But finding the cash for these contributions has not been easy.

Long before OPEB liability was a problem, however, Oakland County, Michigan, began prefunding its retiree health obligations. Over 20 years ago, the County set aside money to pay for its benefit promises through an annual appropriation to an actuarially funded VEBA. Recently, it began funding its remaining OPEB liability through the sales of taxable Certificates of Participation (COP), rather than appropriations. These differ from general obligation bonds because they are not backed by the full faith and credit of the County. However, the County pledged the VEBA assets (now worth over \$303 million) as collateral for the bonds and pledged the interest on the VEBA investments to repay the debt.⁴⁶ Although this approach may not be feasible for many other public employers, it is an interesting approach to consider.

Case Studies: What Can We Learn?

Three important components of a successful stand-alone VEBA are:

1. Having the trust fully funded or as close to it as possible at the beginning;
2. Keeping the plan solvent through profitable investment of plan assets; and
3. Working with retirees to manage patient costs and outcomes.

The VEBA can only be successful if it is better at managing overall costs and care than the employer was prior to the establishment of the VEBA. But that is a formidable task and defining “success” in this context is difficult.

This section of the paper reviews three VEBA case studies to get a sense of how stand-alone VBAs work. Each case study includes: (1) the reason the VEBA was established; (2) implementation date of VEBA coverage; (3) the existing benefit structure at the time and any changes in that structure that were required or prohibited as part of the VEBA establishment; (4) the governance structure of the VEBA; and (5) the source of funding. Although all of these VBAs are relatively new, and none has a long-term track record to examine, some preliminary observations can be drawn about their prospects for meeting their goals.

Case Study #1 – The Dana Corporation

Dana is an example of a company that has established stand-alone VBAs for both union and non-union retirees. In addition, the union VBAs involve two different unions. The VEBA covering non-union retirees immediately changed its benefit delivery structure, but that flexibility is not yet available to the union VBAs. It will be interesting to see how each of these VBAs evolves and whether there will be much of a difference over time between the VEBA covering Steelworker retirees and the one covering UAW retirees.

Dana was a financially troubled automotive components manufacturer located in Toledo, Ohio. The company filed for bankruptcy protection on March 3, 2006, had sought bankruptcy court approval to terminate its three retiree medical plans, and on

January 31, 2007 sought to cancel its collective bargaining agreements with the US Steelworkers and the United Auto Workers. After negotiations, the company reached agreement with representatives of its non-union retirees and both union groups to establish three separate VEBA's and to allow it to terminate its obligation to provide retiree medical benefits. The settlement agreement providing for the establishment of all three VEBA's was approved by the Bankruptcy Court on August 1, 2007.

The settlement with the non-union retirees provided for the company to continue to pay for retiree medical benefits through July 1, 2007. The Retiree Committee has the authority to create new health insurance plans once the VEBA assumes responsibility for paying benefits so there is no requirement that the benefits remain the same, and the Retirees Committee has already altered the benefit options for the non-union retirees. Non-Medicare-eligible retirees now are covered under a preferred provider organization (PPO); their coverage includes prescription drugs. However, Medicare-eligible retirees have only supplemental medical coverage through the VEBA, and they have the right to elect prescription drug coverage through a Medicare Prescription Drug Plan offered by the VEBA.

The settlement agreement with the two union groups locks in the current benefits for a period of time, but then allows modifications to keep the trust solvent.

No information could be found on the public record about the number of members of the Retiree Committee for the VEBA covering non-union retirees.

The union VEBA's are governed by a seven-member board: four public members who must be independent experts and three members appointed by the union. No member of the board can be a current or former official, director, or salaried employee of Dana Corporation. Members serve for life or until death, incapacity, resignation or removal. The chair is selected by the members of the committee.

The company agreed to make a one-time payment of \$78 in cash million to the non-union retirees VEBA.

Dana agreed to pay \$700 million in cash and \$80 million in common stock of the reorganized company to the union VEBA. An independent fiduciary will have control over the employer securities within the VEBA's. Under the settlement agreement, the unions and the company could negotiate an arrangement in which compensation that would otherwise go to active workers be contributed to the VEBA.

Case Study # 2 – the Big Three Auto Companies (GM/Ford/Chrysler VEBA's)

The biggest and most complicated VEBA structure thus far involves the automobile companies. These are also the companies that have received the most intense media scrutiny. How the deteriorating financial position of the companies will affect the funding commitments they have made to the union and retirees must be carefully monitored. If the condition in the recent loan agreements between the Bush Treasury Department

and GM and Chrysler continues in force and at least half the future VEBA payments are required to be in employer securities rather than cash, the protections for retirees embodied in the settlement agreement may be undermined if the value of the companies continues to erode.

The auto companies agreed to establish VEBAs as part of national contract negotiations with the UAW in 2007. As is often the case in these types of complex negotiations, the agreement reached by the parties was in effect memorialized through the filing of lawsuits by the retirees and the union involving each company and then court approval of the respective settlements. The GM and Chrysler settlements were approved by the district courts in 2008; the Ford settlement was approved in August 2008. No appeals to these settlement decisions were filed, so the judgment in each district court approving the settlements was final.

Under the agreements, a single VEBA covering retirees of all three companies was to be established. The new VEBA will not be operational for about two years, or, if later, until all the governmental approvals are received. There are a number of reasons for the parties' decision to delay implementation, including the expected time they knew it would take to secure final approval of the settlement through litigation, the transition time needed to get the administrative and investment infrastructure in place to operate a VEBA trust of this size, and the long lead time necessary to secure the necessary government approvals, including Department of Labor approvals for the contributions of various types of employer securities which might otherwise be prohibited under the Employee Retirement Income Security Act of 1974 (ERISA) and the Securities and Exchange Commission (SEC) approval needed to assure that the transfer of retiree medical obligations is treated as a "settlement" of each of the company's OPEB liability. Thus the target date for the changeover of liabilities is January 2010.

The benefit levels and structures for the new plan will initially be governed by the settlement agreement negotiated in the 2006 lawsuit brought by the UAW and a class of retirees ("the Henry case").⁴⁷ After 2012, however, the committee has some discretion to adjust benefits.

The current implementation plan calls for the auto companies' VEBA to be governed by an 11-person committee which will oversee the trust administration and investments for all three groups of company retirees. However, each group of retirees will have its own separate subaccount under the trust and its own separate plan so that there will be no financial cross-subsidization of one group of company retirees by another. The VEBA trustees have already been appointed by the courts as part of the settlement agreement. Under the agreement, the UAW appointed five members of the committee and all parties agreed on the six independent public members. An interesting feature of the governance structure is a requirement in each settlement agreement that any successful motion must pass with at least one vote from each group.⁴⁸

General Motors agreed to contribute approximately \$35 billion to fund the VEBA. Its initial contribution will be \$24.1 billion, and will pay an additional \$5.4 billion to cover retirees' health care costs until the VEBA is expected to take over in January 2010. The company will also make up to 20 additional payments of \$165 million each (to a maximum of \$1.6 billion) anytime the trust's level is actuarially insufficient to provide benefits for at least 25 years. GM is also required to pay the VEBA cash interest on a \$4.37 billion convertible note which the VEBA's trustee may convert to GM stock. Active workers are also required to contribute four cents per quarter to the VEBA.

Ford agreed to contribute a combination of \$13.2 billion in cash and notes. Contributions will include \$2.7 billion in cash, \$3.8 billion from an existing VEBA, a \$3.3 billion note convertible into about 363 million new shares of Ford stock, a \$3 billion second lien term note and \$400 million in deferred payments. Ford said it expects to realize about \$1 billion a year in net cash flow benefit once the VEBA becomes operational, including a \$1.6 billion per year offset by VEBA contributions.

Because Chrysler is not a publicly traded company, not much information regarding its funding obligations is available. However, according to one source, Chrysler is obligated to contribute \$11 billion to the VEBA – \$7.1 billion in cash, up to 20 additional payments of \$50 million in cash, and \$1.2 billion in other forms of payment and common stock warrants.⁴⁹

Since the time the district courts approved the settlement agreement, two of the companies, GM and Chrysler, have sought federal assistance based on their deteriorating financial condition. In late December 2008, the Bush Administration reached an agreement to extend federal loans to the auto makers and contracts between GM and Chrysler and the Treasury Department were signed that contained various targets and goals for the companies to meet in order to continue to qualify for federal assistance. The only term of these loan agreements that appears to directly impact the promised VEBA funding is a provision that requires each company to make at least half of each required contribution to the VEBA in the form of employer securities rather than cash. Given the fact that this requirement directly conflicts with ERISA (contributions of employer securities under these circumstances are prohibited unless the Department of Labor grants an exemption prior to the contribution), it is unclear how this condition will be enforced without additional action by the Department of Labor. Moreover, since all the terms and conditions of the loan agreement are subject to review and modification, now that the Obama Administration is in office, it is possible that changes to the loan agreements may be adopted that may affect the companies' obligations to the VEBA.

Case Study # 3 – AK Steel

AK Steel is one of the few companies where the level of agreed upon contributions to the VEBA matches the projected liability for promised benefits. The careful way in which the VEBA was negotiated and benefit levels were designed may give this VEBA a reasonable chance of successfully achieving its goals.

After the bargaining agreement between AK Steel Corp. of West Chester, Ohio and the Armco Employees Independent Federation, Inc. expired on February 28, 2006 and the parties could not reach agreement, the union voted to strike. However, on March 1, 2006, the company locked out the union. On June 1, 2006, AK Steel announced it was terminating its retiree health plan effective October 1, 2006 and implementing a new plan with monthly premiums and reduced benefits. A class action lawsuit was filed by a group of retirees in July 2006 to block the company from implementing the new health plan and the court temporarily enjoined the company from doing so.

The company and the retirees settled the lawsuit in October 2007. Under the settlement, the company agreed to establish a VEBA for the 4,600 retirees from its Middletown, Ohio production plant. The court approved the settlement on February 21, 2008 and the VEBA was immediately established.

The new benefit plan for retirees was established as part of the settlement agreement. According to the court, the actuarial consulting firm hired by the plaintiffs “determined the general level of benefits that these payments [by the company] would sustain over the lifetimes of the retirees, and a specific schedule of benefits was developed.”⁵⁰ This is not typically the way benefits are established. Usually the settlement agreement specifies that the current benefits (or some form of modified benefits) will continue for a period of time or discretion is granted to the VEBA committee to establish the plan of benefits.

The VEBA is governed by five trustees – three members of the retiree class and two public trustees.

The company agreed to contribute \$663 million over four years to the VEBA. The company will make an initial payment of \$468 million and three subsequent annual contributions of \$65 million each. Under the actuarial projections, the AK Steel trust is expected to be fully funded for 40-50 years.

Preliminary Conclusions from the Case Studies

Although it is far too early to draw meaningful conclusions from the experiences of the three VEBAs profiled above, they reflect an interesting continuum of possible outcomes.

The Big Three Automakers VEBAs are clearly the most ambitious and complicated of the three case studies, and there are clear cost advantages to be gained by administering them as a single entity. However, the trustees’ ability to adjust and modernize the benefit delivery

structure appears to be constrained because benefits in the future are linked to the benefit structure that was negotiated in 2005 (at least until 2012). But since the long-run fiscal health of the auto companies is unclear, their ability to fund the commitments they made under the settlement agreement is also up in the air.

Each of these VEBAs is designed to be self-sustaining for a considerable period of time, with the AK Steel VEBA appearing to be the most fully funded from the beginning because its plan benefits were carefully and conservatively planned with the available funding in mind. Yet the provisions in the settlement agreements for GM, Ford and Chrysler that require the companies to make additional contributions if the trust assets falls below the level necessary to maintain sufficiency for 25 years could be an important protection if the auto companies' financial health turns around sufficiently to allow them to honor their funding commitments to the VEBA.

In many respects, Dana's VEBAs will face the most daunting sustainability challenge since they will have to assure that the one-time cash infusion is sufficient to carry it through the years. But the Dana retirees had the most to lose if no agreement was reached since the company was already in bankruptcy and the retirees risked getting nothing at all.

All three VEBAs will face unique challenges and it is too early to tell if they will succeed.

Implications and Questions for the Future

The past few years have seen a record number of stand-alone VEBAs established -- all designed to transfer retiree medical liabilities from struggling companies to brand new entities. What will their record of success be?

In the short term, it will be interesting to see if these VEBAs will be able to accomplish this transition from the prior employer plan to a new plan of benefits in a relatively smooth way. The goal of creating a seamless transition for retirees is only attainable with the cooperation and support of the prior plan administration staff and the new committee members responsible for future plan administration tasks. Many retirees may be unhappy at the prospect of losing the "security" of having their former employer provide their medical benefits. It may take time to convince them that the new arrangement is an improvement (or at least not worse than continuing to have the employer responsible for providing coverage).

In some cases, unions have negotiated the ability to provide additional funding streams for the VEBA through contributions by active workers. However, convincing the active workers to divert part of the negotiated salary increases to fund the VEBA may not necessarily be an easy task. The UAW's experience with its so-called "Baby VEBAs" was a positive one – active workers were willing to defer significant amounts of wages and cost-of-living adjustments to contribute to those VEBAs. But given the current economic downturn, it is unclear whether workers will continue to do so or whether the immediate need for higher wages will outweigh the notion of protecting future retiree

medical benefits. If the severe market downturn that has depressed investment results in 2008 and 2009 forces VEBA trustees to reduce the benefits or increase out-of-pocket costs, it is unclear how the union will be able to convince active workers to support the VEBA. And yet, without the possibility of additional revenue if necessary beyond the employer's one-time cash contribution, VEBA trustees may face an insurmountable crunch in the future if they are unsuccessful in controlling costs.

Over the long-term, if the benefit promises are not sustained, retirees may shift their displeasure with their employers to the union or the VEBA trustees when faced with benefit cuts or higher costs from the VEBA.

Moreover, it will be interesting to see whether more private sector employers, particularly in the non-bargained context, decide to establish VEBAs rather than terminate their retiree health plans entirely. Again given the current severe economic downturn, it will be increasingly difficult for employers faced with the need to implement significant layoffs or plant shutdowns to maintain retiree medical benefits at all.

Public sector employers are facing similar challenges in adjusting to their new accounting liabilities. Will state and local governments turn to irrevocable trusts, such as VEBAs, as they cope with these liabilities? And will governments make greater use of bond issues to raise the cash needed to offset their OPEB liability?

At least some policymakers are looking closely at these new VEBAs to determine whether their existence will affect longer-term health and labor market policy challenges, such as the upcoming health care reform debate.⁵¹ Most of the current health care reform proposals are directed at the under-65 population. The employers and unions that have been the most open to VEBA establishment – steel and auto and related industries – all have huge legacy cost concerns and all have to deal with large numbers of early retirees. The biggest expense for the VEBAs (just as it is for employers) is providing health care for this younger retiree group. Presumably there will be significant political pressure to expand health care reform to address these concerns rather than focus only on active workers.

Although existing VEBAs were certainly helped financially by the addition of prescription drug coverage to Medicare, given the current financial crisis and growing deficit, it may not be realistic to expect any additional relief through even a modest Medicare expansion. Yet further changes to Medicare, especially any attempt to change (either reduce or increase) the eligibility age for Medicare, may significantly affect the ability of VEBAs to provide benefits in the future.

Employers, unions and retiree that have supported stand-alone VEBAs are betting that this new approach will be just as good, if not better, at controlling costs and delivering quality health care than the employer-sponsored plans of the past. Are the trustees of these new VEBAs up to the challenge or can they survive? By engaging retirees covered by the plans and the unions that have negotiated them in the actual decision-making necessary to keep the plans viable, policymakers may find that the long-time

goal of creating a more engaged consumer/patient is closer to achievement. While everyone involved in the health care system searches for the key to controlling costs, one intriguing question is whether VEBA's can provide a viable structure for demonstrating whether it is in fact true that focusing on prevention, chronic disease management and lifestyle changes can affect the cost of providing health care, and then convincing consumers of this proposition. The proponents of this new approach are hoping it can do so, since stand-alone VEBA's may be the last best hope of salvaging retiree medical benefits for the remaining retirees still fortunate to have them – but only time will tell.

ENDNOTES

¹ In 1988, 66% of large firms (200 or more workers) that offered health benefits to employees offered retiree coverage. By 2006, only 35% of large firms offered retiree coverage and in 2007, 33% offered coverage. Kaiser/HRET Employer Health Benefits Annual Survey 2007, p. 155, Exhibit 11.1 (Sept. 2008), available at <http://www.kff.org/insurance/7672/upload/76723.pdf>.

² Kaiser/Hewitt Survey of Retiree Health Benefits, 2006, "Retiree Health Benefits Examined," p. 20, Exhibit 17 (Dec. 2006).

³ *Id.*

⁴ Many retirees have found their company health benefits cancelled or dramatically scaled back. Karaim, Reed, "Broken Promises," AARP Bulletin, April 13, 2006, available at http://www.aarp.org/health/insurance/articles/broken_promises.html.

⁵ 12,128 tax returns were filed on behalf of VEBAs in Fiscal Year 2007. See IRS Data Book: 2007, Table 25, available at <http://www.irs.gov/taxstats/article/0,,id=168593,00.html>. In 2007, 356 applications for tax-exempt status were filed by IRC § 501(c)(9) organizations. *Id.* at Table 24, available at <http://www.irs.gov/taxstats/article/0,,id=168593,00.html>.

⁶ Section 101(16) of the Revenue Act of 1928 authorized tax-exempt status for VEBAs and subsequent reenactments of the Internal Revenue Code continued this tax-favored treatment although the provisions authorizing it were moved from section to section as the Code was revised. VEBAs received their current designation under IRC § 501(c)(9) when they were incorporated into the 1954 Code. However, no regulations were proposed until 1969 and final regulations under IRC §501(c)(9) were published in the Federal Register on January 7, 1981. For a more complete history of VEBAs, see Section F of the 1984 EO CPE Text, available at <http://www.irs.gov/charities/nonprofits/article/0,,id=154610,00.html>.

⁷ Under IRC §§ 419 and 419A, contributions are limited to the "qualified asset amount limit."

⁸ IRC § 419A(f)(5).

⁹ IRC § 419A(c)(2).

¹⁰ Another group of workers and retirees that ordinarily have funded health benefits are those in multiemployer health and welfare plans. Multiemployer plan are health plans to which two or more employers contribute under bargaining agreements between the employers and one or more unions. They are also sometimes called "Taft-Hartley" plans because under the Taft-Hartley Act (the Labor-Management Relations Act) the exemption from the prohibition against employers providing anything of value to a labor union can be satisfied only when contributions by employers on behalf of members of a labor union for health benefits are made to a trust governed by equal numbers of representatives of labor and management. LMRA § 302(c)(5) (see note 11 below for further explanation).

¹¹ Section 302(c) of the Labor-Management Relations Act of 1947 (also called the Taft-Hartley Act), 29 U.S.C. §§141-197, prohibits employers from paying, lending or delivering any money or other thing of value to a representative of employees and imposes criminal penalties for willful violations of this prohibition. However, employers can pay, lend or deliver money to a trust fund established by a labor organization for the sole and exclusive benefit of employees of the employer (and their families or dependents) if the payments are held in trust for the purpose of paying benefits, such as medical care or pensions, and a number of other requirements are satisfied. LMRA §302(c)(5).

¹² Section 3(1) of ERISA defines an employee welfare benefit plan, in relevant part, as a "plan, fund, or program ... established or maintained by an employer or by employee organization, or by both [to provide] participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care, or benefits in the event of sickness, accident, disability." 29 U.S.C. § 1002(1). As an employee welfare benefit plan, VEBAs subject to ERISA would be required to comply with all the provisions that any other welfare plan would be, including the reporting, disclosure, fiduciary responsibility and claims procedures requirements. VEBAs providing retiree medical benefits would be treated as group health plans under ERISA and the Code.

¹³ The Segal Company, *Study of Retiree Health VEBAs*, Winter 2008, available at <http://www.segalco.com/publications/surveysandstudies/2008VEBAs.pdf>.

¹⁴ Section 1113 of the Bankruptcy Code establishes a nine-point procedure that debtors must follow before the bankruptcy court will issue an order allowing rejection of the contract, including presenting a proposal to modify the agreement to the union and a requirement that the proposal be fair and equitable to all parties. 11 U.S.C. §1113.

¹⁵ Section 1114 of the Bankruptcy Code. 11 U.S.C. §1114.

¹⁶ Keating, Daniel, "Harsh Realities and Silver Linings for Retirees," 15 Am Bankr. Inst. L. Rev. 437, 454 (Winter 2007). According to the author, Dana agreed to make a payment of \$703 million in cash and \$80 million in stock

¹⁷ Geisel, Jerry, "Retiree health VEBA's may be start of trend: Deal by Dana Corp. may spur future financing deals," *Business Insurance* (Crain Communications), Vol.41, Iss. 29, 1 (July 16, 2007).

¹⁸ Tower's unsecured creditors appealed a decision of the U.S. Bankruptcy Court, 342 B.R. 158, approving these settlements of the debtor with the unions representing employees and retirees as well as a settlement between the debtor and the retirees committee. The creditors sought to have the settlement set aside arguing that it favored one group of unsecured creditors (the retirees) over other similarly situated unsecured creditors. The U.S. District Court for the Southern District of New York upheld the bankruptcy court's decision to approve the settlement in *In re Tower Automotive Inc.*, 241 F.D.R. 162 (S.D.N.Y. 2006), holding that this protection is consistent with Congress' intent in enacting Section 1114. The court described the terms of the agreement as guaranteeing each VEBA a floor of 20% recovery on the outstanding balance of the retirees' unsecured claims against the debtor, with the payments due on a series of specified dates in 2006 and 2007. The unsecured claims for retirees in the largest VEBA totaled \$150 million, representing approximately 56% of Tower's total unsecured claims. 241 F.D.R. at 161. However, the court also noted that Tower expected to emerge from bankruptcy with an enterprise value of approximately \$1.2 billion, so that this guarantee for retirees would still leave the company with substantial assets after bankruptcy. *Id.*

¹⁹ In 2005, the UAW agreed to reopen bargaining on its existing multi-year contract with GM after the company convinced the union that the burden of its ongoing retiree medical costs out it at a serious disadvantage with competitors (such as Toyota with a younger active worker population and fewer retirees) and could force the company into bankruptcy. Teresa Ghilarducci, "The New Treaty of Detroit: Are Voluntary Employee Benefits Associations Labor's Way Forward, or the Remnants of a Once Glorious Past?" (March 2008) at p. 18 and 20, available at <http://teresaghilarducci.org/research/documents/ghilarduccirevisedMarch2008.doc>.

²⁰ In exchange for a series of concessions by the union, GM agreed, among other things, to establish a defined contribution VEBA (DC-VEBA) to reduce the monthly contributions, deductibles, out-of-pocket maximums and other retiree health costs as well as fund the retiree dental plan. However, GM agreed to be responsible for providing retiree health coverage. The DC-VEBA funds were to be used to mitigate the monthly out-of-pocket expenses of retirees. *UAW et al v. General Motors Corp.*, 2006 WL 891151 *5-6 (E.D. MI 2006).

²¹ Ford agreed to establish a defined contribution VEBA (DC-VEBA) and the funds in the VEBA were to be used to mitigate the new out-of-pocket expenses that retirees would have to pay under the new health plan. *International Union v. Ford Motor Co.*, 2006 WL 1984363 (E.D. MI 2006).

²² *UAW v. General Motors Corp.*, 2006 WL 891151 at *7.

²³ *Id.*

²⁴ *International Union v. Ford Motor Co.*, 2006 WL 1984363 at *12.

²⁵ *Id.*

²⁶ Ghilarducci at 3, available at

<http://teresaghilarducci.org/research/documents/ghilarduccirevisedMarch2008.doc>.

²⁷ O'Brien, Ellen, "Retiree Health Care: What Do the New Auto Industry VEBA's Mean for Current and Future Retirees?", AARP Public Policy Institute, March 2008, at 7, Table 1, available at http://www.aarp.org/research/health/privinsurance/i4_veba.html.

²⁸ MSNBC, "\$17.4 billion auto bailout has strings attached," Dec. 19, 2008, available at <http://www.msnbc.msn.com/id/28311743/>.

²⁹ "Vesting" means that the individual would have a right to receive the promised benefit as long as he or she fulfilled all the required service and other criteria even if he or she left employment. ERISA's vesting provisions (ERISA §203, 29 U.S.C. 1053 and IRC §411, 26 U.S.C. 411) apply only to pension plans.

³⁰ See generally Payne, William and Ewing, Pamina, "Union Negotiated Lifetime Retiree Health Benefits: Promise or Illusion," 9 Marq. Elder's Advisor 319 (Spring 2008).

³¹ A relatively recent twist in this rather predictable scenario occurs when the employer terminates or reduces the benefits and then immediately moves to sue its own retirees as a preemptive strike and asks the court to declare the employer's actions lawful. Payne at 319.

³² The author has been appointed by the court as a public trustee on the Goodyear VEBA's Administrative Committee. The settlement agreement establishing the VEBA was approved by the U.S. District Court for the Northern District of Ohio, Eastern Division on August 22, 2008. The case is Reddington v. Goodyear Tire & Rubber Co., Case No. 5:07-cv-1999, filed July 3, 2007.

³³ *Bailey v. AK Steel Corp.*, 2008 WL 495539 (S.D. Ohio 2008). Under the settlement agreement, AK Steel is required to make a total cash payment of \$663 million to the VEBA; the first payment of \$468 was made within two days of the approval of the settlement agreement and the rest will be paid in three annual payments of \$65 million (although initially placed in escrow if necessary until the exhaustion of all appeals). One unusual feature of this settlement agreement is that the benefit structure for the life of the VEBA is established through the settlement agreement itself. Apparently the actuaries hired by the plaintiffs projected the cost of the benefits over the life of the retirees and that is how the contribution amounts were determined. In contrast, in the UAW/GM, Ford, Chrysler and Goodyear settlements, benefit levels were established for a period of time but then trustees of the VEBA will be required to determine whether those levels can be sustained or whether adjustments (within certain parameters) should be made. The VEBA, which is already up and running, is governed by a five-person board of trustees composed of three trustees who are class members ("Retiree Trustees") and two trustees who are not class members ("Public Members"). 2008 WL 495539 at *7.

³⁴ See Summary of Statement 106, available at <http://www.fasb.org/st/summary/stsum106.shtml>.

³⁵ Ferman, John, "Retiree Health Coverage," *Healthcare Executive*, Vol. 23, Issue 3, at 50 (January 1, 2008).

³⁶ *Bailey v. AK Steel Corp.*, 2008 WL 495539, at *1 (S.D. Ohio 2008).

³⁷ Sales or exchanges of property, including securities, between a plan and an employer whose employees participate in the plan are prohibited under ERISA (and the corresponding sections of the tax code) unless the conditions described in ERISA §408(e), 29 U.S.C. §1108(e) are satisfied. Contributions of employer securities to satisfy funding requirements have long been treated as sales under ERISA.

³⁸ See, for example, the exemption granted for the VEBA of the Retirees of Kaiser Aluminum Co. to accept contributions in the form of Kaiser Aluminum stock. Prohibited Transaction Exemption 2006-16, 71 Fed. Reg. 70992 (12/7/06), available at <http://www.dol.gov/ebsa/regs/fedreg/notices/2006020729.htm>.

³⁹ The VEBA approach is often mischaracterized as one which shifts liability for paying these benefits from the employer to the union, since many of these new arrangements arise from collective bargaining relationships either directly through contract negotiations or through the settlement of class action litigation brought by union retirees. But in actuality, the union is not generally the entity that will have the legal responsibility for paying retiree medical benefits in the future. The new entity, the stand-alone VEBA, is typically governed by an independent board of fiduciaries, which may include union and/or retiree representatives as well as public members, is the entity the legal responsibility for paying retiree medical benefits to which retirees must look for their future health benefits. For instance, the Goodyear VEBA is governed by a committee consisting of four public members, three members representing the Steelworkers and two members representing the retiree class. Similarly, the AK Steel VEBA is governed by a 5-person committee with three retiree class members and two public trustees.

⁴⁰ Critics frequently point to the Caterpillar VEBA as an example of the difficulty a VEBA may encounter. Originally funded with approximately \$33 million in 1993, in 2004, the VEBA ran out of money, thus requiring retirees to unexpectedly face substantial increases in out-of-pocket costs. *The Oakland Press*, "VEBA Slammed by UAW Dissidents," Sept. 28, 2007, web story only, available at http://www.theoaklandpress.com/stories/092807/loc_20070928122.shtml. A number of lawsuits have been filed by retirees against Caterpillar and the company has sued the UAW. Kelly, Susan, "New GM Slogan: Viva the VEBA," *Workforce Management*, October 2007, available at http://www.workforce.com/section/02/feature/25/17/56/251759_printer.html. However, a recent publication by the AARP Public Policy Institute provides more detail on the Caterpillar experience and concludes that describing the Caterpillar VEBA as bad for workers may be unfair. O'Brien, Ellen, "Retiree Health Care: What Do the New Auto Industry VEBAs Mean for Current and Future Retirees? AARP Public Policy Institute, March 2008, at 11, Box 2, available at http://www.aarp.org/research/health/privinsurance/i4_veba.html.

⁴¹ The Segal Company, *Study of Retiree Health VEBA's*, Winter 2008, available at <http://www.segalco.com/publications/surveysandstudies/2008VEBA's.pdf>. Although not necessarily a representative sample of all VEBA's, this study sheds some light on a cross-section of some of them.

⁴² *Id.* at p. 2, Graph 2.

⁴³ *Id.* at p. 2, Graph 4.

⁴⁴ The easiest way to reduce or eliminate OPEB liability for retiree medical benefits for both governmental and private employers is to switch from a defined benefit approach to providing benefits to a defined contribution approach. The employer's promise is then a limited cash amount, not a specified package of benefit whose cost could vary from year to year.

⁴⁵ Davoit, Steve, "Vive la VEBA! Benefit Trust Ready for a Comeback," *Employee Benefit News*, Jan. 1, 2006, 2006 WLNR 17639468.

⁴⁶ Sanford, Paula, "The Implementation of GASB 45: Case Studies of 15 Counties." National Center for the Study of Counties and the National Association of Counties. December 2007, at 34.

⁴⁷ *UAW et al v. General Motors Corp.*, 2006 WL 891151 (E.D. MI 2006).

⁴⁸ Teresa Ghilarducci, "The New Treaty of Detroit: Are Voluntary Employee Benefits Associations Labor's Way Forward, or the Remnants of a Once Glorious Past?" (March 2008) at p. 13, available at <http://teresaghilarducci.org/research/documents/ghilarduccirevisedMarch2008.doc>.

⁴⁹ FitzGerald, Edmond, "Revisiting VEBA's. PLI, Tax Law and Estate Planning Course Handbook (May 1, 2008), 802 PLI/Tax 573, 582-583.

⁵⁰ *Bailey v. AK Steel Corp.*, 2008 WL 495539, at *5 (S.D. Ohio 2008).

⁵¹ On December 1, 2008, the U.S. Department of Labor's Office of Policy issued a request for information (RFI) about stand-alone VEBA's. 73 Fed. Reg. 72841 (Dec. 1, 2008). Comments were due by December 31, 2008 and only three were filed. Among other things, the Department was interested in the role that VEBA's can play in the evolving labor market changes that may affect the provision and delivery of retiree benefits.



The Henry J. Kaiser Family Foundation

Headquarters

2400 Sand Hill Road
Menlo Park, CA 94025
phone: 650.854.9400
fax: 650.854.4800

**Washington Offices and
Barbara Jordan Conference Center**

1330 G Street, NW
Washington, DC 20005
phone: 202.347.5270
fax: 202.347.5274

www.kff.org

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