

June 3, 2013

Alex Gurza
Deputy City Manager
City of San Jose
200 E. Santa Clara Street
San Jose, California 95113

Re: Coalition's Attached Counter Proposal on Retiree Healthcare

Dear Mr. Gurza:

The San Jose Federated Labor Coalition¹ ("Coalition") submits the attached counter proposal in response to the City's counter proposal dated May 30, 2013. The Coalition's counter proposal does not seek to "kick the can down the road" or take a piecemeal approach to the challenge of retiree healthcare. Rather, the Coalition's counter proposal takes direct aim at coming up with comprehensive, long-term solutions.

- 1. The Retiree Healthcare Solutions Working Group establishes the kind of problem-solving environment needed to develop comprehensive, long-term solutions.**

Like its previous proposal, the cornerstone of the Coalition's counter proposal is the creation of a stakeholder working group called the Retiree Healthcare Solutions Working Group. The singular purpose of the working group is to explore, analyze and ultimately find viable, long-term solutions to retiree healthcare. To help accomplish the working group's purpose, this counter proposal – like the Coalition's previous one – includes the use of a mutually agreeable, independent facilitator to assist the parties.

The Coalition *firmly* believes there are solutions to the complex and difficult challenges of retiree healthcare. The Retiree Healthcare Solutions Working Group is the Coalition's attempt to move beyond traditional labor negotiations based on the exchange of proposals to a more collaborative, problem solving, "can do" environment in which all possibilities can be explored. Traditional labor negotiations based on the exchange of proposals has not been a successful model for mutually resolving large, complex and difficult labor issues, i.e. retirement benefits and retiree healthcare

¹ The San Jose Federated Labor Coalition consists of the following 9 bargaining units: Association of Building, Mechanical, and Electrical Inspectors (ABMEI), Association of Engineers and Architects (AEA), Association of Legal Professionals (ALP), Association of Maintenance Supervisory Personnel (AMSP), City Association of Management Personnel (CAMP), Confidential Employees' Organization (CEO), International Brotherhood of Electrical Workers (IBEW), Municipal Employees' Federation (MEF) and International Union of Operating Engineers, Local #3 (OE#3).

benefits. On the other hand, the kind of stakeholder group proposed by the Coalition has been successful at resolving similarly complex and difficult issues.

The Coalition's commitment to this approach is evident in its counter proposal. As indicated in the counter proposal, the Coalition is committed to putting all issues on the table in the Retiree Healthcare Solutions Working Group – including the following:

- Using high deductible healthcare medical plans in combination with individual health savings accounts,
- Limitations on the current retiree healthcare benefit in combination with individual health savings accounts,
- Tiered healthcare benefit structures based on length of employment;
- Modification of eligibility requirements,
- Health plan design and rate structures changes,
- Incentives for employees to work beyond normal retirement eligibility, and
- The inclusion or exclusion of new employees in any modifications, or the formation of a completely different plan for new employees.

The Coalition's proposal to pay its share of the costs of the facilitator also reflects its commitment to the working group approach. ***Coalition members would rather spend their money on a productive process aimed at finding solutions than on contentious litigation.*** The Coalition hopes the City feels the same way.

Unfortunately, the City's counterproposal cuts the heart and soul out of the Coalition's proposal by (1) eliminating the use of an independent facilitator and (2) by shifting the primary focus of the working group to education rather than to finding long-term solutions. While education will be a component of finding solutions, the Coalition is not interested in a group that primarily seeks to educate. The Coalition believes firmly that the primary focus of the Retiree Healthcare Solutions Working Group must be to find long-term solutions to retiree healthcare. Moreover, to find such solutions, the Coalition believes it is critical to have an independent facilitator. Indeed, the Coalition believes having a facilitator is so critical that we are willing to pay for our share of the cost.

In our last negotiations, it was suggested that this kind of stakeholder group has been tried before. However, the Coalition is unaware of any previous stakeholder group formed by the City and retiree healthcare stakeholders for the exclusive purpose of finding long-term solutions to retiree healthcare. The stakeholder group formed in 2008-2009 appears to have had the primary purpose of implementing full funding and GASB. Moreover, it appears the stakeholder group was discontinued once agreements were reached on implementing full funding and GASB, and the City returned to traditional labor negotiations to try to solve the retiree healthcare challenge.

The City's attempt to shift the primary focus of the working group to education underestimates the incredible wealth of knowledge and experience the Coalition brings to the table. The Coalition consists of a broad cross section of City employees.

Throughout our careers with the City, we have all been asked by the City on multiple occasions to solve difficult problems and to "think out of the box." So, let's establish an environment that will let us do just that!

2. Including fiscal years 2013/2014 and 2014/2015 in the "ramp up" is reasonable under the circumstances.

The Coalition's counter proposal continues the "ramp up" in fiscal years 2013/2014 and 2014/2015. Under the counter proposal, full payment of the ARC would occur in fiscal year 2015-2016. In addition to providing City employees with some relief from the last few years of salary cuts and takeaways, the counter proposal is aimed at (1) providing time for the Retiree Healthcare Solutions Working Group to be successful and (2) delaying the need to transfer money to the qualified 115 trust, thus allowing more time for the City to obtain a private letter ruling from the IRS.

No one – including the Federated Retirement Board – has raised a serious concern that extending the ramp up would cause a financial problem. The City's December, 2012 proposal on retiree healthcare would have continued the ramp up to a cap of 10 percent of pensionable pay. As you indicated in one of our recent negotiating sessions, this would have extended the ramp up for somewhere between 2 to 3 years. The City's last two proposals would "extend" the ramp up through the end of fiscal year 2013-2014. The Coalition's counter proposal is consistent with the City's December proposal and only extends the ramp up for one year beyond the City's two most recent proposals.

Under the circumstances, the Coalition's counter proposal is very modest and reasonable. This is particularly true given the dispute over when payment of the ARC begins under the language of the approved retiree healthcare plan and the fact that changed circumstances seriously undermine the basis of the minimum five-year "ramp-up" period.

The City Council memorandum dated April 7, 2009 states that the retiree healthcare funding plan was based on "the adoption of a reasonable ramp-up period, i.e., one not less than five years, to reach full funding." The stakeholder group that was formed to address this issue was convinced that a ramp up to full funding over a time period of less than five years would not be reasonable. It believed a ramp up of five years or a period longer than five years would be reasonable and prudent.

Since April 7, 2009, changed circumstances have completely altered the underlying basis used by the parties to determine what constituted a "reasonable" ramp-up period. Many of these changed circumstances involved unilateral actions by the City. In addition to the "great recession," the changed circumstances include the following.

- **Actuarial Analysis:** The actuarial analysis upon which the parties relied in 2008-2009 in determining a reasonable ramp-up period never reflected an

annual employee contribution rate increase even approaching 0.75%. The annual contribution increases for employees shown in the actuarial analysis ranged from a low of 0.24% to a high of 0.32%. The actuarial analysis estimated that the total contribution for employees in fiscal year 2013-2014 would be 6.10%. The more recent actuarial estimates of the employee contribution rate needed to pay the ARC far exceed any rate that could have been reasonably anticipated in 2008-2009.

- **Compensation Reductions:** Since April, 2009, the City implemented a minimum 10% reduction (12 plus % in some cases) in total compensation for all employees as well as a number of other compensation and benefit takeaways.
- **Workforce Reduction/Retirements:** Since April, 2009, the City has significantly reduced its workforce and there were a significant number of retirements, both of which caused the unfunded liability to increase dramatically. There are currently about 2,000 fewer employees since the layoffs, retirements and forced departures from the City.
- **Healthcare Plan Changes:** As of 2008-2009, a Kaiser HMO, *non-deductible* medical plan had been the lowest-priced medical plan available to City employees. In 2008-2009, there was no indication that this would change. Following April, 2009, the City unilaterally implemented a lower cost, *high-deductible* medical plan. The coalition members negotiated the “ramp-up” agreement based on the healthcare benefit always having been a non-deductible plan. The City’s unilateral implementation of a lower cost, high deductible plan means the Coalition members are now paying more for a lesser benefit.
- **Tier 2 Retirement for New Employees:** The City established “tier 2” retirement benefits for new employees that pushes the retirement age out to 65 years of age. As a consequence, the City is now proposing to remove such employees from retiree healthcare. As discussed below, this would cause the contribution rates to soar!

The Coalition’s counter proposal provides a reasonable resolution of all these issues while providing the parties with an appropriate amount of time to mutually reach long-term solutions to retiree healthcare.

3. To give the Retiree Healthcare Solutions Working Group time to be successful, labor negotiations need to be temporarily suspended.

The City’s counter proposal contemplates continuing labor negotiations simultaneously with the working group. This works under the City’s counter proposal because the City envisions the primary purpose of the working group as being educational. However, if the purpose of the Retiree Healthcare Solutions Working Group is truly to find long-term solutions to retiree healthcare – as the Coalition intends – then continuing labor negotiations would be counterproductive.

The Coalition's counter proposal would suspend labor negotiations **on retiree healthcare** for one year for those Coalition members participating in the Retiree Healthcare Solutions Working Group. The independent facilitator would have the authority to recommend a 6-month extension of the suspension of labor negotiations. Although neither party would be obligated to accept the recommendation, neither party could unreasonably reject it. Labor negotiations could resume as soon as the working group makes any recommendations or when the period of suspension ends.

The Coalition's counter proposal is aimed at giving the Retiree Healthcare Solutions Working Group a real chance to succeed.

4. The City's proposal does not answer the question of what happens if the IRS rules that contributions to the 115 Trust must be treated as post tax.

The Coalition appreciates the City's proposal with regard to the 115 Trust. However, the City's proposal does not address the primary concern of the Coalition members.

The Coalition is concerned the City will begin making contributions to the 115 Trust before receiving a private letter ruling from the IRS that such contributions can be treated as pre-tax. If the IRS determines that such contributions should be treated as post-tax, the City's proposal would indemnify employees for contributions made **before** the IRS determination. This, however, still leaves the problem of what happens to employee contributions **after** such an IRS ruling. The Coalition requests the City to indicate how it would intend to address such a situation.

5. The detriment of immediately closing the plan to new employees far outweighs any detriment to the City from keeping them in the plan.

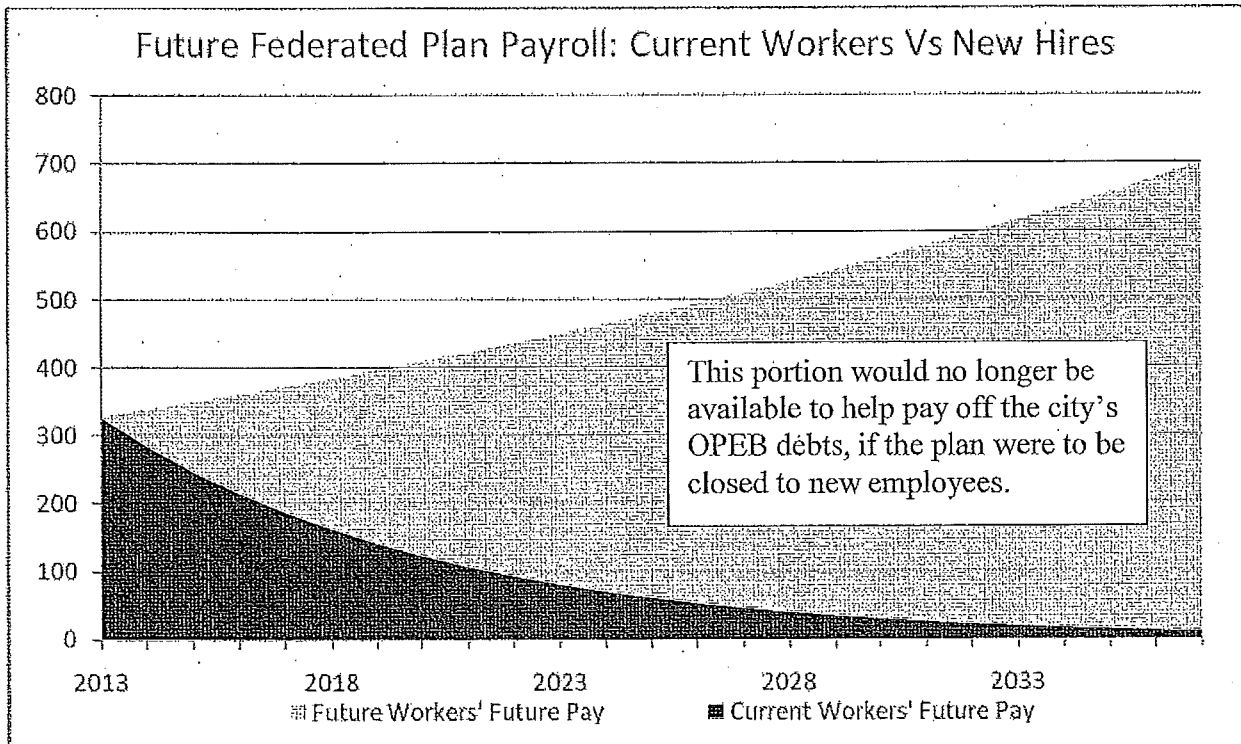
The Coalition's counter proposal is to have the issue of what retiree healthcare benefit new employees receive be part of the Retiree Healthcare Solutions Working Group. The Coalition proposes that, in the interim, new employees pay the "normal cost" of retiree healthcare and the City pay any unfunded liability associated with such employees.

The detriment of immediately closing the plan to new employees without any long-term solutions far outweighs any detriment to the City from keeping new employees in the plan. If the City were to close the plan to new employees, the present value of future plan payroll would decline immediately, as actuaries will no longer assume new entrants would be hired to replace those leaving. The Coalition believes that, as a rough rule, payroll would fall by 50% every 5 years. The Coalition suspects the actual decline (if not the projected decline) would be much worse given the low morale, existing demographics, and pressure that declining take-home pay will create on individuals with other employment prospects.

Therefore, closing the retiree healthcare plan to new employees would have a catastrophic impact on the plan. The City's own recent analysis conducted by an outside consultant concluded that closing the plan could result in contribution rates

soaring to 164 percent (82 percent for employees/82 percent for the City) in 20 years. From what limited information the City has made available thus far, closing the plan to new employees would compromise the future integrity of the plan and virtually doom the plan.

Couple plan closure to new employees with declining payroll, and the costs become front-loaded, as future payroll (the basis for amortization charges) is naturally front-loaded in a closed plan. The following chart shows, roughly, what the Coalition would expect with regard to future payroll in typical scenarios.



Future Federated Plan Payroll: Current Workers Vs New Hires

On the other hand, there appears to be little detriment to the City in keeping new employees in the current retiree healthcare plan. The only reason set forth in the City's previous retiree healthcare proposal for wanting to close the plan is to avoid new employees having "to belong to a plan with such a high cost to the employee for a benefit that will likely have little value. . ."

However, the current situation has not been an impediment to hiring new employees. A memorandum from you to the City Council dated May 1, 2013 regarding "Update on Hiring" states that "[o]verall, applicant response to City job postings demonstrates a strong interest in the City as an employer." It also states:

It is important to note that in Fiscal Year 2011-2012, the total number of positions filled was 893. Therefore, we have already filled more positions in the first 8 months of Fiscal

Year 2012-2013 than in all of Fiscal Year 2011-2012. . . [¶] .
. . . In conclusion, while there are challenges in some areas,
the City is experiencing overall strong interest from job
seekers once positions are posted.

And even more recently, a memorandum from you to the City Council dated May 14, 2013 regarding "Update on Hiring" states that "[h]iring activity has continued to be high..."

In short, while immediate plan closure would be catastrophic, there is little apparent detriment to the City from keeping new employees in the plan. Given these circumstances, the discussion of closing the plan to new employees should occur in the context of a conversation about long-term solutions for all of the employees represented by the Coalition.

6. **The Coalition agrees to a four-tier rate structure for medical and dental benefits for active employees.**

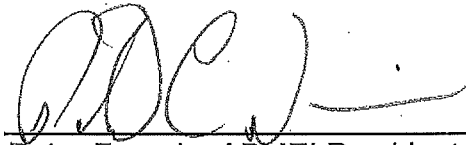
Each of the last three City retiree healthcare proposals has included implementing a four-tier rate structure for medical and dental benefits. The Coalition believes that the City has a serious legal problem with moving from the existing "single and family" rate structure for medical and dental benefits to a four-tier rate structure. The retiree healthcare benefit, which the City concedes is a vested right, expressly provides that the payment is for the "lowest of the premiums for **single and family** medical insurance coverage. . ." (SJMC Section 3.24.2280 (1).) As the Coalition members have previously asserted, the four-tier rate structure conflicts with this vested right.

The Coalition members want to be clear that they represent **active** employees, not retirees, and that their proposed agreement to a four-tier rate structure is only as to **active** employees. The Coalition members also want to make clear that their proposed agreement is made in reliance on the City's position that implementing such a rate structure is lawful (presumably the City would not repeatedly make a formal proposal that it believes is unlawful).

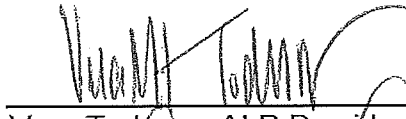
The Coalition looks forward to meeting with you to discuss its counter proposal and this letter.

Sincerely,

San Jose Federated Labor Coalition



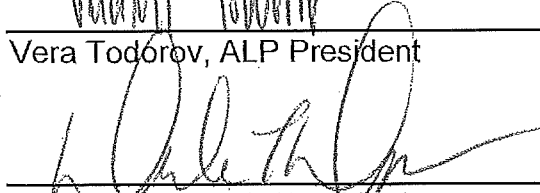
Peter Fenerin, ABMEI President



Vera Todorov, ALP President



John Mukhar, AEA President



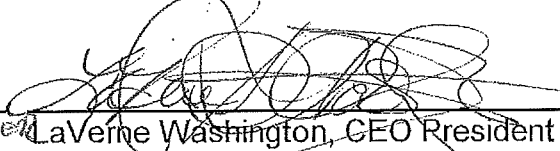
Dale Dapp, AMSP President



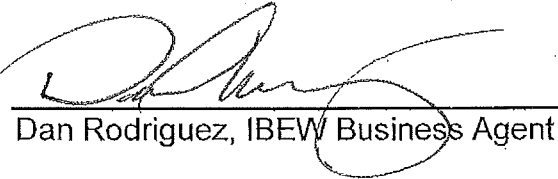
FOR Matt Farrell, CAMP President

ALAN WILLEY

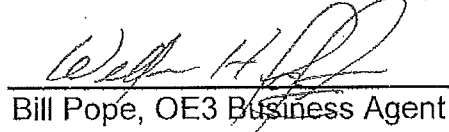
Treasurer



LaVerne Washington, CEO President



Dan Rodriguez, IBEW Business Agent



Bill Pope, OE3 Business Agent



Yolanda Cruz, MEF President

Cc: Mayor and Council Members
Debra Figone
Rick Doyle
Federated Retirement Board
Harvey Leiderman

Side Letter Agreement

The City and the San Jose Federated Labor Coalition¹ ("Coalition") agree that they must address a number of challenges regarding retiree healthcare. This side letter agreement is intended to be an *interim* resolution of issues pending the City and Coalition agreeing to one or more long-term solutions. The City and the Coalition agree on an interim basis as follows:

1. Application of Side Letter Agreement:

This side letter agreement applies to the current terms and conditions of employment applicable to employees of the Coalition, and applies notwithstanding anything to the contrary in any existing or expired memorandum of understanding. These terms and conditions shall be incorporated into any new memorandum of understanding negotiated and entered into by the City and any bargaining unit in the Coalition after execution of this side letter agreement.

2. Retiree Healthcare Solutions Working Group:

- a. **Purpose:** The City and the Coalition shall form a Retiree Healthcare Solutions Working Group ("Working Group"). The singular goal of this Working Group is to make one or more mutually agreeable recommendations regarding long-term solutions to retiree healthcare. The Working Group is formed based on the belief of the parties that there are viable solutions to this complex and difficult issue. To this end, the Working Group seeks to move beyond traditional labor negotiations based on the exchange of proposals and to a more collaborative, problem solving, "can do" environment in which all viable possibilities will be explored, including the following:

- Using high deductible healthcare medical plans in combination with individual health savings accounts,
- Limitations on the current retiree healthcare benefit in combination with individual health savings accounts,
- Tiered healthcare benefit structures based on length of employment,
- Modification of eligibility requirements,

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- Health plan design and rate structures changes,
- Incentives for employees to work beyond normal retirement eligibility, and
- The inclusion or exclusion of new employees in any modifications, or the formation of a completely different plan for new employees.

- b. **Facilitator:** Before November 15, 2013, the City and Coalition members will mutually agree on an independent person or entity that is knowledgeable in the area of retiree healthcare benefits to facilitate the Working Group. If the City and Coalition cannot mutually agree on a facilitator, then the City and the Coalition will each select one representative and those two representatives will select the facilitator.

The facilitator will facilitate the discussions, provide information to the parties, and make non-binding recommendations to the parties. Upon the mutual agreement of the City and Coalition members, the facilitator will have the authority to engage subject matter experts to assist in analyzing possible solutions.

The City and Coalition will equally share in the costs of the facilitator.

- c. **Participation:** In addition to the City and a representative from each bargaining unit in the Coalition, members of the Working Committee will include a representative of the retirees and any unrepresented employee group(s).
- d. **Meetings:** The City and Coalition will jointly schedule Working Group sessions in coordination with the facilitator. More frequent and longer Working Group sessions will be scheduled in the early stages of the process. The Working Group sessions will be open to employees and the public.

3. Retiree Healthcare Funding and Benefits:

- a. **Plan Members:** The Plan member (active employees) cash contribution rate for retiree healthcare shall not have an incremental increase of more than 0.75% in each of the fiscal years 2013/2014 and 2014/2015. The Plan members shall begin contributing their portion of the full Annual Required Contribution in the first pay period of fiscal year 2015/2016.
- b. **City:** The City cash contribution rate shall not have an incremental increase of more than 0.75% in each of the fiscal years 2013/2014 and 2014/2015. The City shall be contributing its portion of the full Annual Required Contribution by no later than the first pay period of fiscal year 2014/2015 and 2015/2016 respectively.

4. Retiree Healthcare Benefit Negotiations:

a. **Temporary Suspension of Negotiations:** If a bargaining unit that is a member of the Coalition participates in the Working Group, then the City and that bargaining unit agree as follows with regard to meeting and conferring over retiree healthcare:

- The parties will temporarily suspend retiree healthcare negotiations during fiscal year 2013/2014 in order to provide a reasonable opportunity for the Working Group to be successful.
- If the Working Group facilitator believes the Working Group is progressing towards one or more long-term solutions and believes the Working Group would benefit from a further suspension of negotiations, the facilitator may make a written recommendation to the parties to continue the suspension of negotiations for a period of up to 6 months. If the facilitator makes such a recommendation, none of the parties will unreasonably withhold its consent to suspend negotiations for the recommended additional period of time.
- Notwithstanding the period during which negotiations are suspended, if the Working Group makes a final recommendation as to one or more long-term solutions, then the parties will meet and confer over retiree healthcare upon the request of either party. Negotiations shall commence within 14 calendar days upon notice of either party. The City and the Coalition shall negotiate in good faith in an effort to reach a mutual agreement. Applicable impasse dispute resolution procedures shall apply.
- Following the period during which negotiations are suspended, the parties will meet and confer over retiree healthcare upon the request of either party. The City and the Coalition shall negotiate in good faith in an effort to reach a mutual agreement. Applicable impasse dispute resolution procedures shall apply.

b. **Exception:** If any bargaining unit that is a member of the Coalition decides at any time not to participate in the Working Group, then the City and that bargaining unit will meet and confer over retiree healthcare upon the request of either party. The City and that bargaining unit shall negotiate in good faith in an effort to reach a mutual agreement. Applicable impasse dispute resolution procedures shall apply.

5. Qualified 115 Trust:

The City can begin utilizing the 115 Trust provided that this action follows the City receiving from the IRS a specific Private Letter Ruling applicable to the City of San Jose that states that contributions to the Trust are treated as pre-tax expenditures. The City shall not deposit employee retiree healthcare contributions into a 115B Trust unless a PLR from the IRS specific to the City of San Jose states the employee contributions will be pre-tax contributions. Should the City fail to obtain such a PLR prior to reaching the limits for the 401H account, the City may deposit employee contributions into the 115B Trust after issuing an executed agreement with coalition organizations requiring the City to indemnify employees for any and all adverse tax consequences.

NOTE TO CITY: Please see the attached cover letter regarding the Coalition's request for how the City intends to address the negative impacts on employees that would result from an IRS ruling that contributions made to the 115 trust must be treated as post tax.

6. New Employees:

Employees hired into full-time benefited positions on or after the first pay period following the execution of this side letter agreement by the City and Coalition will pay all normal costs associated with the retiree healthcare benefit. The City will pay the unfunded liability contributions associated with such employees.

7. Health Insurance:

Effective January 1, 2014, all available plans will have a 4-tier rate structure (Employee, Employee plus spouse/domestic partner, Employee plus Child(ren) and Family). The premiums will be adjusted effective the first pay period in payroll calendar year 2014, which starts December 22, 2013.

8. Dental Insurance:

Effective January 1, 2014, all available plans will have a 4-tier rate structure (Employee, Employee plus spouse/domestic partner, Employee plus Child(ren) and Family). The premiums will be adjusted effective the first pay period in payroll calendar year 2014, which starts December 22, 2013.