Practical Considerations in Seeking to Reduce Retiree Health Care Costs

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In 1960, health care spending in the United States consumed only 4.7% of GDP.[1] By 2009, however, spending on health care in the United States exceeded 17% of GDP – totaling $2.5 trillion, or an average of $8,047 per person. American spending on health care is only expected to continue to grow, reaching $4.5 trillion in 2019, or 19.3% of GDP.[2]

Retiree medical care is even more expensive than health care for workers and dependent children. According to the U.S. Department of Health and Human Services, "[p]er person personal health care spending for the 65 and older population was $14,797 in 2004," which was "5.6 times higher than spending per child ($2,650) and 3.3 times spending per working-age person ($4,511)."[3] Those numbers have only continued to increase.

Years ago, when health care benefits were significantly cheaper, companies often could afford to provide quite generous retiree benefits. Given the explosion in costs, however, many companies have had to pare down or eliminate such benefits. Common approaches include instituting a cap on employer contributions, instituting or increasing co-pays and deductibles, and terminating post-age 65 coverage. There are often very significant benefits to a company's bottom line from reducing or eliminating retiree medical benefits.

The following sets forth practical considerations when evaluating a company's ability to reduce or terminate retiree medical benefits.

The Legal Landscape: Retiree medical benefit plans in the private business sector are governed by the Employee Retirement Income Security Act of 1974 ("ERISA"). Retiree medical benefits are generally "unfunded," meaning that companies have not set aside money to pay future benefits. Retiree medical benefits differ from pension/401(k) benefits in that medical benefits generally are not "vested," meaning that they can often be reduced or terminated.

The key legal issue is whether the benefits have "vested" under the terms of the plan. If the benefits are vested, that creates a lifetime right to a certain level of retiree medical benefits, and the benefits cannot be changed or eliminated without retirees' consent. Whether benefits are vested is a legal question that depends on the interpretation of the relevant contracts and documents, typically including the plan document, summary plan description ("SPD"), relevant collective bargaining agreement ("CBA"), and in some cases, other communications with former or present employees.

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[1] http://www.cbo.gov/ftpdocs/87xx/doc8758/MainText.3.1.shtml (last visited 3/22/2011).
[2] http://www.usatoday.com/news/health/2010-02-04-health-care-costs_N.htm (last visited 3/22/2011).
[3] https://www.cms.gov/NationalHealthExpendData/25_NHE_Fact_Sheet.asp (last visited 3/22/2011).

The law on retiree medical vesting varies dramatically among federal courts nationwide. For collectively-bargained union retiree medical benefits, the Sixth Circuit Court of Appeals in the Yard-Man case created a presumption that retiree medical benefits are vested for life. The presumption may only be rebutted if there is explicit language in the applicable CBA that such benefits are *not* intended to be permanent or for life.

On the other hand, examining the same language, the neighboring Seventh Circuit Court of Appeals in the Senn case took an opposite position. The court concluded that where a CBA provides no language as to the duration of benefits, retiree benefits terminate upon expiration of the CBA under which the retirees retired. The court found that benefits provided after termination of that CBA were gratuitous and could therefore be changed or eliminated.

Courts are more stringent in analyzing CBA language and finding that vesting occurred in the union-negotiated context, although a finding of vesting is by no means automatic. In the non-union context, courts are more likely to find no vesting, particularly if the governing documents contain "reservation of rights" language reserving the employer's ability to change or terminate benefits in the future.

Typically, courts do not allow juries to hear ERISA claims, including those challenging an employer's changes to retiree medical benefits. However, if the challenges pertain to union employees, such suits are typically brought under both ERISA and the Labor Management Relations Act ("LMRA"), and the LMRA generally provides for a jury trial. While courts in that situation should bifurcate the claims so that the jury does not hear the ERISA claims, some courts refuse to do so.

Making Changes to Retiree Medical Benefits: A significant amount of legal and business analysis should accompany any decision to change or terminate retiree medical benefits. Careful due diligence is required. The company should gather the relevant documents, including CBAs, health plan documents and disclosures, and communications regarding retiree medical benefits. A list of the documents to consider is attached hereto.

It is very helpful to have clear and unambiguous "reservation of rights" language in the relevant documents. If no such language exists, or if the language is unfavorable, the company should consider adding clear reservation of rights language going forward. In addition to examining these documents with the assistance of counsel, the company should learn what key personnel, such as senior human resources and benefits managers, understood at the relevant times regarding the intended duration of retiree medical benefits.

The company should also look at the relevant plan delegations and amendment procedures to ensure that the formalities of any change to retiree medical benefits comply with terms of the plan documents and ERISA. It is critical to identify which officer(s) have authority to make changes, as well as which executives and board members should be involved in the decision making process. Another important step in the analysis is to retain the appropriate outside consultants to provide a valuation of the effect of the changes. Such consultants should be hired through outside counsel so as to increase the likelihood that their findings will be shielded from later disclosure in the event of litigation.

Often it is useful to have the consultant price out different levels of changes, particularly if there is a desire to try to negotiate a change in the level of benefits, such as with a union, before litigation occurs. Doing so allows the company to start with a proposal that is valued at a cost to the company lower than what the company needs or desires to achieve, in order to end up in negotiations at a level which is acceptable given the company's financials and goals. Caution is needed to carefully evaluate whether to make such changes permanent, i.e., not subject to future change, or to provide a sunset provision when retiree benefits can be revisited.

A key issue is the scope of the changes. One approach is an outright termination of benefits effective as of a certain date. This is an option particularly where plan documents contain favorable language. The goal may be a favorable settlement for the company through the litigation which often follows such changes. The savings to the company's bottom line from reducing benefits will often dramatically outweigh the costs of litigation or settlement.

Another approach is incrementalism. An incremental approach may include gradually increasing or introducing retiree monthly premiums, co-pays, and deductibles. This is a common approach where plan documents or CBAs contain less favorable language. The goal may be to make sufficient incremental changes to save money without triggering a lawsuit or labor unrest among active employees.

This approach also allows the company to test the waters, and determine whether retirees or the union are likely to challenge the changes. If they do not, their silence can often serve as proof in any later lawsuit that the retirees or union understood that the benefits were not vested. A further consideration is that smaller changes will often be tolerated, while outright termination often incites those affected.

The company should also develop a game plan for announcing the changes. This should include a careful and comprehensive plan for announcing the changes (including whether to give any representative union courtesy notice); monitoring the reaction of employees and retirees (including in online retiree forums); setting up a hotline number for questions and responses, with careful logs to monitor calls; and having a litigation plan in place. The last of these is particularly important if the relevant facilities, retirees, or plan administration are geographically dispersed, given, as discussed above, the differences in law among jurisdictions.

The company will naturally want to litigate, if at all, in a "friendly" court. To increase the chances of doing so, the company must be willing to bring the lawsuit as a fiduciary, so as to have standing under ERISA, and must present a "case or controversy" seeking a declaration of its right to change or terminate retiree medical benefits. Proof of an actual dispute between the parties is needed for such an action. In addition, the lawsuit must have a sufficient connection to the court in which it is filed to prevent transfer or dismissal of the case.

Planning for Litigation: The most important tool in beginning the process of changing or terminating retiree medical benefits is *awareness*. This applies to the company's knowledge of its retiree population, including the attitudes and level of cooperation of union negotiators in the past, or any dissidents or troublemakers. The company will need to give thought to who might be an appropriate candidate to name as a defendant in the event the company files the lawsuit.

Former union representatives, such as the retired head of a local union office, are one possibility. This can help lessen the consequences of bad publicity associated with forcing unassuming retirees into a lawsuit. Of course, public relations are a critical element of any consideration over future changes or termination of retiree medical benefits.

It must be noted, however, that it is often difficult to convince a court to certify a "defensive" class action whose result would bind all company retirees nationwide. If the number of retirees is relatively small (such as in the hundreds), it is possible to name all of them individually as defendants, thereby foreclosing separate litigation. Nonetheless, there are often benefits to filing a declaratory judgment action, including obtaining a favorable ruling that can be used as precedent in the event of later litigation.

In addition to the lack of jury trials, and the fact that the case will be heard in federal rather than state court, there are other aspects of ERISA which limit the potential exposure to employers. Primary among these is that no compensatory or punitive damages are permitted under ERISA. The only risk is a court order that the benefits be reinstated, and the possibility, though only discretionary, that the prevailing party may obtain its legal costs.

Changes to retiree medical benefits do not always result in litigation. Depending on the scope of the changes, and the jurisdiction in which the case is likely to be heard, retirees and their potential counsel may conclude that the risks of litigation outweigh any benefit. Having highly experienced counsel advise the company on the steps that should be taken, and the risks and advantages involved, is essential in navigating this complex area of law in a manner most beneficial to the company.

Retiree Medical Benefits -- Document Checklist

- All plan documents and summary plan descriptions for all groups of employees who are eligible for retiree health care. This should include each and every version of such documents since retiree health care was provided.
- All collective bargaining agreements covering all employees who are eligible for retiree health care.
- All employee communications, including, but not limited to, enrollment materials, newsletters, or other documentation to employees discussing retiree health care.
- Any insurance contracts or third party administrative contracts and employee communications sent to employees, if applicable, regarding any health care benefits offered from the employer.
- All pension plans, summary plan descriptions, and pension enrollment forms or packages covering salaried or hourly employees that may provide for retiree medical coverage.
- All individual employment agreements under which post-termination medical benefits are discussed.
- All exit program materials, early retirement incentive programs, retirement estimate letters, and benefits enrollment kits.
- All other informal communications sent to retirees and potential retirees.
- Form 5500s and attached schedules and financial information for all retiree medical plans and group health plans that cover retirees for the past 5 years.