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# VEBAs – The Answer To Healthcare Benefits Costs For Retirees?

*The Editor interviews* ***Steven J. Sacher****, Jones Day.*

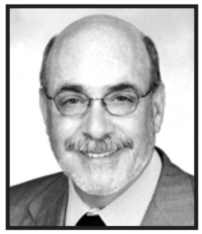
**Editor: Mr. Sacher, would you tell our readers something about your professional experience?**

**Sacher:** Following law school I was in government practice, first at the Department of Labor and then at the U.S. Senate Labor Committee. While at the Labor Department, I co-chaired a task force that worked closely with the Congressional drafters of the Employee Retirement Income Security Act (ERISA). In 1981 I left the Senate and entered the private practice of law. My area of expertise is employee benefits, with a particular focus on ways in which pension and other employee benefit plan assets can be invested. I represent corporate clients on these matters with the federal regulatory agencies and in the federal courts.

The assets held in U.S. benefit plans constitute the largest source of investment capital in the world. This is an evolving and dynamic field, and new forms of benefits and new ways in which to deliver benefits appear constantly, as financial services companies compete to attract investing plans. The aging and pending retirement of the Baby Boomers is another important factor.

**Editor: Legacy benefit costs – particularly healthcare benefit costs for retirees – is one of the major issues before the American economy. For starters, how did this crisis develop?**

**Sacher:** The origins of the present crisis date back to the 1950s and '60s, when employers began to sponsor healthcare plans for their employees. At the time, health plan benefits were all provided through insurance, and the cost of healthcare benefits for retirees was very low. For example, in order to obtain the employer's business in covering active employees, the insurance companies often agreed to cover retirees without additional cost to the employer. Needless to say, many employers accepted the offer. This was also an era of corporate paternalism. People often spent their entire careers with one company, and, as a consequence, the company felt responsibility for their well being beyond active employment. As did unions for their members facing retirement. It all worked because at this time there were six active employees for every retiree, and retirees did not live as long following retirement as they do today.



**Steven J. Sacher**

In the 1970s things began to change. Global competitors emerged. The U.S. economy began to shift from an industrial workforce to one engaged in service oriented work. Worker mobility – job shifts from one company to another – became the norm. Most significantly, the cost of providing healthcare benefits began to grow at a rate significantly greater than the general inflation rate. And retirees were beginning to live longer as a result of improved healthcare. Companies, particularly in the old smokestack industries, began to feel the pinch. At a time when, very often, their revenues were declining, they found themselves obligated by contract to pay big-time retiree health benefits. Typically, it was a full ride: no limitations on coverage, no deductibles or co-pays, and a rich array of benefits.

Employers began to look for ways in which to reduce these obligations. That led to disputes between companies and their retirees and, if unionized, the unions that had represented the retirees while they were employed. Those disputes have been going on since at least the early 1980s. Where these disputes led to lawsuits, confusion reigned. These matters are decided in federal court, and the law varies depending on the federal circuit in which they are brought. Some circuits are more sympathetic to the retirees, others to the companies. The only certainty is that these disputes are not going away, which is one of reasons we call them legacy cost disputes. Whether they concern healthcare benefits for employees or retirement benefits for employees, the issues are essentially the same: they involve people who are no longer employed and contributing to the company's bottom line, while the company is on the hook to provide benefits.

**Editor: Everyone is aware of how this issue has impacted the American automobile industry. Are there other industries or industry sectors that face a similar challenge?**

**Sacher:** Sure, communications and airlines are examples. Steels are another, although there aren't many of those left.

**Editor: How did the new accounting rules forcing companies to add retiree healthcare costs to their balance sheets as a liability influence the discussion?**

***Please email the interviewee at sjsacher@jonesday.com with questions about this interview.***

**Sacher:** FAS 106, which was promulgated in the early '90s, simply exacerbated the existing situation. It states that if the company is providing healthcare benefits to retirees, the liability associated with those benefits must be shown on the company's books – on the balance sheet in the financial statements. That has always been the case with respect to pension-related liabilities, but until the issuance of FAS 106 the liability with respect to retiree healthcare or insurance benefits could be handled with a footnote and did not appear on the balance sheet. Depending on the size of the retiree population and the nature of the benefits, the liability can be huge, and the investment community does not react positively. That can affect a company's ability to issue debt, the ranking of that debt and, ultimately, the value of its common stock.

**Editor: What is the origin of the vehicle known as the Voluntary Employee Beneficiary Association or VEBA?**

**Sacher:** The VEBA is a type of tax-exempt trust under the Internal Revenue Code. The income earned from the assets held in such a trust is not taxable, and that favorable tax treatment has been available for decades. VEBAs, accordingly, are not new, but they became increasingly important as companies were forced to book the retiree health liabilities. Companies began to set up and fund VEBA trusts because the trust assets as a practical matter offset the liability.

**Editor: Please tell us about the proposed agreement between General Motors and the United Automobile Workers with respect to a VEBA.**

**Sacher:** This continues to be under negotiation. In the fall, the parties reached certain understandings about a new kind of VEBA that helped them to successfully negotiate a new labor contract, but it was always contemplated that there would be further refinement of their thinking, and that is in process now.

Basically, however, GM and the other U.S. auto manufacturers determined that they can no longer carry the liability of legacy retiree healthcare benefits, that the liability is too detrimental to the financial strength of the company. They are reported to have told the UAW that they must shed this liability, and that they have some ideas on how to do it, but if the UAW was not receptive they, the union, would have to live with the risk that the company could be driven out of business altogether. That is, in the absence of some resolution, there was not only the possibility that these benefits to retirees would be lost but also that the jobs of active employees – the vast majority being union members – would disappear or, at the very least, be considerably disrupted.

The idea is that the company will terminate its retiree health plan and transfer substantial assets, in the scores of billions of dollars for all three companies, to a new VEBA trust – to be administered by a committee consisting of UAW and independent members – and the new VEBA trust will pay the retiree health benefits. I understand that the actuaries are looking at how much is necessary to provide an investment return that will result in substantially the same benefits to retirees, for a lengthy period of years, as they have now. Once those assets have been turned over to the new VEBA trust, the company plans will be terminated and the liability on the balance sheet eliminated. As a result, the company's financial picture should improve, more revenues can be used for product development, and the U.S. companies will be better able to cope with their global competitors, many of which do not have retiree health obligations because those are assumed by state-sponsored programs paid for by taxpayers.

**Editor: AT&T and Verizon Communications, Inc. are taking a long, hard look at how the GM-UAW arrangement develops. Anything to report on this front?**

**Sacher:** Many companies are looking at the proposed GM-UAW arrangement. Other Jones Day clients, including Goodyear and Dana Corporation, have already taken this step. But it is not for everyone. For starters, even where the company has a massive liability on its books, it must have substantial assets to contribute to the new VEBA. Otherwise, there is little incentive on the part of the other side to negotiate.

**Editor: In your view, is the VEBA arrangement a permanent solution to the problem, or is it a stopgap measure to keep key industries going until we have developed a national healthcare insurance program that covers everyone?**

**Sacher:** Good question, but I'm not sure that anyone knows the answer. The unions have made it clear that in their view VEBA arrangements do not constitute the final answer. They favor a national healthcare program. Particularly if a Democratic Administration emerges from next November's election, we may see some kind of national healthcare proposal under discussion within a couple of years. In the meantime, we have entered a new stage of development in the arena of employer-sponsored benefits. As with most developments in this field, it is economics-driven and it also represents a fundamental change in industrial relations in this country. The discussion covers a wide range of options, from individual accounts in which people invest on a tax-exempt basis and draw down the assets as needed for healthcare purposes to national state-sponsored healthcare programs. And everything in between, including the new VEBAs.

**Editor: What about the future? How do you see this area of the law developing over, say, the next five years?**

**Sacher:** We've been talking about VEBAs on the heathcare side. A significant occurrence that we have not addressed is the parallel development with respect to retirement income: pension liability buyouts or transfers. The concept is similar. There are liabilities for legacy pension benefits on the books of many companies that they would like to shed, and there are well-to-do financial institutions with an ability to assume those liabilities and administer pension fund assets with greater facility and a better return than heretofore enjoyed by the companies. Getting the two together on this has not occurred in the U.S., but there have been several transactions in the UK, where the regulatory regime is not as restrictive as it is here. There is a great deal of interest here, and I know that a number of federal agencies, including the Labor Department, the Pension Benefit Guarantee Corporation, the IRS and the Treasury Department, are considering how to react to this interest. Depending on what they do, we may see many transactions of this type.