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## Hidden in Plain Sight - VEBAS: Shifting the Risk of Retiree Benefits to Retirees

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## HIDDEN IN PLAIN SIGHT—VEBAS: SHIFTING THE RISK OF RETIREE BENEFITS TO RETIRES

Timothy R. Hurley\*

*What's good for the country is good for General Motors, and vice versa.*<sup>1</sup>

### I. INTRODUCTION

Imagine growing up as a young boy not wanting to become a professional baseball player, fireman, or lawyer. Instead, you were awestruck when you visited your dad at work and “saw the line of hulking orange-and-silver robotic arms swinging with rhythmic precision.”<sup>2</sup> You wanted to become an autoworker at General Motors (GM) because your dad was an autoworker there. Not only that, your grandfather, grandmother, great-grandfather, step-grandmother, aunt, and great-uncle all worked at GM. This story is not imaginary for some. In fact, this was the dream of a ten-year-old boy growing up in Michigan. He and his family have now spent four generations at GM—a combined total of 300 years and seven decades building automobiles.<sup>3</sup> This generation, however, could be the last.

Needless to say, GM is in serious financial trouble as are the other American auto manufacturers. On February 12, 2008, GM announced a \$38.7 billion loss, the largest ever for an automaker, and offered buyouts to all of its 74,000 employees in an attempt at an economic turnaround.<sup>4</sup> For 2008, GM reported a net loss of \$30.9 billion.<sup>5</sup> Most recently, GM received \$13.4 billion in government bailout money and has requested an additional \$16.6 billion to help it survive.<sup>6</sup> GM is not alone—Ford posted a \$14.6 billion

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1. *Respectfully Quoted: A Dictionary of Quotations, Statement of Charles Erwin Wilson, President of GM*, <http://www.bartleby.com/73/352.html> (last accessed Mar. 28, 2010).

2. Fox News, *Family's 4th Generation at GM Could Be Its Last*, <http://www.foxnews.com/story/0,2933,486266,00.html> (Jan. 31, 2009).

3. *Id.*

4. Nick Bunkley, *\$722 Million Quarterly Loss at G.M.*, <http://www.nytimes.com/-2008/02/12/business/12cnd-auto.html> (Feb. 12, 2008). See also Bill Vlasic, *G.M. Offers New Buyout to 74,000*, 157 N.Y. Times C1 (Feb. 13, 2008).

5. GM, *Preliminary Fourth Quarter and Calendar Year 2008 Financial Results*, [http://198.208.187.166/archive/documents/domain\\_828/docId\\_52444\\_pr.html](http://198.208.187.166/archive/documents/domain_828/docId_52444_pr.html) (Feb. 26, 2009).

6. See egmCarTech, *GM Reports a \$30.9 Billion Loss for 2008*, <http://www.egmcartech.com/-2009/02/26/breaking-gm-reports-a-309-billion-loss-for-2008/> (Feb. 26, 2009).

loss<sup>7</sup> and Chrysler incurred an \$8 billion loss.<sup>8</sup> With these financial woes, the Big Three Automakers<sup>9</sup> have been forced to slash jobs. According to the Center for Automotive Research, the Big Three Automakers cut their workforce by about 40% from 2001 to 2007.<sup>10</sup> Between 1978 and 2003, the number of employees dropped from 667,000 to 275,000.<sup>11</sup> At the end of 2007, they employed 239,341.<sup>12</sup> Recent buyouts, however, have left the Big Three Automakers with 172,000 employees and more cuts are looming.<sup>13</sup>

There is no one particular cause for the Big Three Automakers' financial problems. Their problems have been widely linked to, among other things, increased competition in the marketplace, higher gas prices, the housing market, and the general state of the economy in 2008 and 2009. More often than not, however, the automakers blame their downfall on legacy costs.<sup>14</sup> For example, GM forecasts that its legacy costs will reach \$6 billion a year—or 900,000 additional car sales—by 2013.<sup>15</sup> Currently, welfare benefits, specifically retiree medical benefits, are causing the most significant financial strain on the companies because, as explained more fully below, employers typically have not prefunded these benefits.

The Big Three Automakers, however, are not alone. As the cost of healthcare has increased substantially, the cost of providing medical benefits for retirees has exploded for any employer that promises these benefits in retirement. As a result, employers are either cutting benefits or terminating them altogether. Many employers with retiree benefit liabilities, however, have “hung their hat” on the Voluntary Employee Beneficiary Association (VEBA) as the basis for continuing benefits in retirement and for securing a financial turnaround.<sup>16</sup> While properly funded VEBAs can both provide continuing benefits to retirees and shift liabilities from a company's balance sheet, there

7. Ford, *Fourth Quarter and Full Year 2008 Earnings Review and 2009 Outlook*, [http://www.ford.com/doc/ir\\_20090129\\_4q08\\_financial\\_results.pdf](http://www.ford.com/doc/ir_20090129_4q08_financial_results.pdf) (Jan. 29, 2009).

8. See Jewel Gowani, *Chrysler Loss to Shrink This Year*, <http://www.freep.com/article/20090222/BUSINESS01/902220448> (Feb. 22, 2009).

9. Any reference to the “Big Three Automakers” in this paper means GM, Ford, and Chrysler.

10. David Cole et. al., *The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers 2*, <http://graphics8.nytimes.com/packages/pdf/autorecess.pdf> (Nov. 4, 2008).

11. Jeffrey S. Rothstein, *Lean Times: The UAW Contract and the Crisis of Industrial Unionism in the Auto Industry*, 17 *New Lab. Forum* 61, 67 (No.2, 2008).

12. David et al., *supra* n. 10, at 2. Honda and Toyota employed roughly 113,000 people in the United States at that time. *Id.*

13. Rothstein, *supra* n. 11, at 67.

14. Fox News, *supra* n. 2. “Legacy costs” are the costs to employers of providing retirees with pensions and welfare benefits in retirement.

15. Pres. Auto Task Force, *Determination of Viability Summary: General Motors Corporation 4*, [http://www.whitehouse.gov/assets/documents/GM\\_Viability\\_Assessment.pdf](http://www.whitehouse.gov/assets/documents/GM_Viability_Assessment.pdf) (Mar. 30, 2009).

16. For example, after being sued by retirees, AK Steel contributed \$663 million to a VEBA to fund benefits for the life of each class member. *Bailey v. AK Steel Corp.*, 2008 WL 495539 at \*2, \*4–6 (S.D. Ohio Feb. 21, 2008). Goodyear also recently reached a settlement with the United Steelworkers union and agreed to contribute \$1 billion into a VEBA to fund retiree health benefits. Jim Mackinnon, *Goodyear, USW Agree to Establish Health Care Fund*, <http://www.ohio.com/business/10909151.html> (Oct. 31, 2007). Goodyear is expected to save \$110 million a year by establishing a VEBA. *Id.* Perhaps the most widely reported is the GM VEBA. As part of a collective bargaining agreement between General Motors and the United Auto Workers union, General Motors agreed to contribute \$30 billion, or 70 cents on the dollar, to a VEBA. Jerry Geisel, *GM Puts Brakes on Retiree Health Benefits: Automaker, Union Embrace VEBA Enabling GM to Offload \$50 Billion in Obligations*, 41 *Bus. Ins.* 1 (Oct. 1, 2007). GM and UAW recently agreed to modify the original GM VEBA. See GM, *2009–2014 Restructuring Plan*, <http://www.financialstability.gov/docs/AIFP/GMRestructuringPlan.pdf> (Dec. 31, 2008). Ford and Chrysler both have VEBAs as well.

are significant issues with VEBAs. For example, they shift the risk and responsibility of providing benefits from the employer to the retirees—once the employer funds the VEBA, its responsibility to the retirees usually ends. This risk shifting, VEBAs in general, and how and why employers find themselves in this financial legacy mess are the foci of this article. Before discussing VEBAs and how they shift the risks to retirees, it is important to understand the landscape of welfare benefits and, specifically, retiree medical benefits.

Part II of this article provides the foundation for understanding how and why an employer can cut retiree welfare benefits. It first defines what a welfare benefit is and then explores their development, including how retirees first came into possession of these benefits. Part III explores the plight of the retiree and how they depend on these once-promised benefits in retirement only to have them reduced or eliminated. Part III then discusses the legalities of terminating these benefits. It examines the Employee Retirement Income Security Act of 1974 (ERISA) and its dichotomy—strict regulation of pension plans versus weak regulation of welfare plans. Part IV provides an in-depth analysis of the provisions of VEBAs under Internal Revenue Code § 501(c)(9) and the applicable Treasury Regulations. Part V discusses how ERISA’s weak regulation of welfare benefits allows employers to shift the risk of retiree benefits to retirees themselves through a VEBA. Finally, Part VI explores the “safeguards” provided by the Bankruptcy Code to protect retiree benefits when a company enters Chapter 11 bankruptcy. The article concludes by advocating for an amendment to ERISA to provide stricter regulation of welfare plans, similar to the regulations already in place for pension plans.

## II. RETIREE WELFARE BENEFITS

### A. *What Are “Welfare Benefits”?*

ERISA defines “welfare benefits” as:

any plan . . . established or maintained by an employer or by an employee organization . . . for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services . . . .<sup>17</sup>

Because of the unique position that welfare benefits hold,<sup>18</sup> the Internal Revenue Code (IRC) provides its own definition of “welfare benefits” as employee benefits other than (1) property transferred for the performance of services, or (2) retirement benefits or

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17. ERISA, Pub.L. 93-406, § 3(1), 88 Stat. 829 (1974). Although the term “welfare benefits” encompasses a wide variety of benefits, the most common is paid time off—77% of workers in private establishments received vacation in 2006. Lawrence A. Frolik & Kathryn L. Moore, *Law of Employee Pension and Welfare Benefits* 81 (2d ed., Lexis 2008). The next most common benefit was medical care benefits with 53% of employees receiving such benefit, followed by life insurance (50%), and educational assistance (49%). *Id.*

18. Both the Internal Revenue Code through the Internal Revenue Service and ERISA through the Department of Labor regulate employee pension benefit plans and employee welfare benefit plans.

deferred compensation programs.<sup>19</sup> Welfare benefits, however, existed long before they found their place in ERISA or the IRC.

In those early times, employers did not customarily provide welfare benefits to their employees.<sup>20</sup> Employees, therefore, banded together to establish what were commonly known as “mutual benefit associations” to provide medical care, life insurance, death benefits, and other welfare benefits to their members.<sup>21</sup> Typically, employees of a single employer or small groups of several local employers formed and managed these associations.<sup>22</sup> These associations were the earliest form of health insurance in the United States.<sup>23</sup>

In 1913, the Sixteenth Amendment, which constitutionalized the imposition of the income tax, jeopardized the solvency of mutual benefit associations.<sup>24</sup> In *Philadelphia & Reading Association*,<sup>25</sup> the court found that in 1888, the employees of the Philadelphia & Reading Railroad Company formed a mutual benefit association to provide payment for “disablement from accident, sickness or other cause, and, in the event of their death, to their relatives . . . .”<sup>26</sup> The court held that the mutual benefit association was an “association” as the Revenue Act of 1918 defined the term.<sup>27</sup> The Revenue Act of 1918, therefore, subjected the association “to the income and profits taxes imposed upon corporations.”<sup>28</sup> The court further held that the mutual benefit association was not exempt from the tax as other “fraternal beneficiary associations” were.<sup>29</sup>

At the time, there was concern that, although these organizations performed valuable social functions, they might not be able to continue to exist without a tax exemption. By contrast, larger associations covering employees of unrelated employers in different geographic areas [were] more likely to be viable without a tax exemption, and the benefits they provide[d] [were] more likely to be available through commercial insurance.<sup>30</sup>

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19. I.R.C. § 419(c)(2) (2006); see also I.R.C. §§ 83, 404, 404A.

20. Walter W. Miller, *VEBAs May Be the Solution for Client's Welfare Benefit Plans*, 7 J. Tax'n. Emp. Benefits 35, 35 (May/June 1999).

21. *Id.*; see also *Whitehurst v. Whitehurst*, 1 S.E. 801 (Va. 1887) (discussing who is entitled to a deceased's death benefit from a mutual benefit association); Joseph P. Chamberlain, *The Practicability of Compulsory Sickness Insurance in America*, 4 Am. Lab. Legis. Rev. 49, 72 (1914) (discussing the Flint Vehicle Factories Mutual Benefit Association that was organized in 1901); *Recent Michigan Decisions*, 5 Mich. L.J. 142, 143-44 (1896) (noting a case where a plaintiff sued a mutual benefit association for death benefits). These “mutual benefit associations” had similar structures, benefits, and features and are considered the predecessors to the modern day VEBA.

22. Miller, *supra* n. 20, at 35; see also Prop. Treas. Reg. § 1.509(c)(9), 57 Fed. Reg. 34886-02, 34887 (Aug. 7, 1992) (quoting Preamble to 26 CFR 1 (1981)).

23. See Medical Risk Managers, *A Short History of Medical Insurance*, <http://www.mrm-mgu.com/sections.asp?sec=42> (last accessed Mar. 16, 2010). Voluntary mutual protection associations developed in the United States in the late 1800s. *Id.* “One of the earliest of these, La Société Française de Bienfaisance Mutuelle, was organized in San Francisco in 1851. This society was noteworthy for having established a hospital in 1852 to provide care for its members.” *Id.*

24. Miller, *supra* n. 20, at 35.

25. 4 B.T.A. 713 (U.S. Bd. of Tax App's. 1926).

26. *Id.* at 715.

27. *Id.* at 723.

28. *Id.*

29. *Id.* at 724-725.

30. Subcomm. on Taxn. of the Sen. Comm. on Fin., *Tax Simplification Bills: Hearings on S. 1384, S. 1394, and H.R. 2777*, 102d Cong. 260 (Aug. 7, 1992) (quoted in Prop. Treas. Reg. § 1.509(c)(9), 57 Fed. Reg. at 34887).

Congress, therefore, in response to *Philadelphia & Reading Association*, amended the IRC to grant tax-exempt status to qualified mutual benefit associations.<sup>31</sup> These mutual benefit associations were essentially the predecessors to modern day VEBAs.

World War II, however, caused a move away from these benefit associations toward a vast expansion of employer-provided welfare benefits in the United States.<sup>32</sup> During the war, the Office of Price Administration froze wages to stabilize the economy, but allowed employers to provide additional fringe benefits in lieu of higher wages.<sup>33</sup> When the soldiers returned from the war, they sought insurance similar to the government-provided benefit they received in the military.<sup>34</sup> Employers, facing wartime tax rates as high as 85%, were happy to provide welfare benefits because they could deduct these benefits as business expenses.<sup>35</sup> By 1954, employers provided health insurance coverage for 70% of all workers.<sup>36</sup>

Since 1980, however, employer-provided health insurance has steadily declined. In 1980, 66.3% of employees had access to employer-provided health insurance coverage.<sup>37</sup> By 1990, however, this number had declined to 62.2%.<sup>38</sup> Today, the U.S. Census Bureau estimates that employer-provided health insurance covers only 59.3% of employees.<sup>39</sup>

### B. Retiree Benefits

In addition to the vast expansion of employer provided health care benefits to employees, in the 1940s and 1950s, employers—primarily those employers in union industries such as coal, steel, and automobile manufacturing—began providing for continued medical benefits in retirement after an employee provided a certain number of years of service to the employer.<sup>40</sup> In those days, providing these benefits was a goodwill gesture—a means of obtaining and retaining quality employees.<sup>41</sup> One commentator noted that this gesture began as a “ ‘throw away benefit,’ inexpensive to provide and lightly granted.”<sup>42</sup>

The number of employers offering retiree health benefits, however, has

31. Miller, *supra* n. 20, at 35.

32. In 1935, Baylor University was the first employer to offer health insurance to its 1,200 employees at \$5.36 per year. Dayna Bowen Matthew, *Controlling the Reverse Agency Costs of Employment-Based Health Insurance: Of Markets, Courts, and a Regulatory Quagmire*, 31 Wake Forest L. Rev. 1037, 1041 (1996).

33. *Id.* at 1041–1042.

34. *Id.* at 1041.

35. *Id.* at 1042. This effectively allowed the employers to spend \$0.15 on each after-tax dollar offering these benefits. *Id.*

36. Matthew, *supra* n. 32, at 1042.

37. Cong. Budget Off., *The Tax Treatment of Employment-Based Health Insurance*, [http://www.cbo.gov/ftpdocs/95xx/doc9527/-1994\\_03\\_TaxTreatmentOfInsurance.pdf](http://www.cbo.gov/ftpdocs/95xx/doc9527/-1994_03_TaxTreatmentOfInsurance.pdf) (Mar. 1994).

38. *Id.*

39. Carmen DeNavas-Walt, et al., *Income, Poverty, and Health Insurance Coverage in the United States: 2007* 19 (U.S. Census Bureau Aug. 2008) (available at <http://www.census.gov/prod/2008pubs/p60-235.pdf>).

40. Daniel Keating, *Why the Bankruptcy Reform Act Left Labor Legacy Costs Alone*, 71 Mo. L. Rev. 985, 986 (2006); David A. Pratt, *The Past, Present and Future of Retiree Health Benefits*, 3 J. Health & Biomedical L. 103, 110 (2007).

41. Keating, *supra* n. 40, at 986; Pratt, *supra* n. 40, at 110.

42. Pratt, *supra* n. 40, at 110 (quoting Diana J. Scott, Project Manager, Financial Accounting Standards Board).

significantly declined since the 1980s. According to the 2008 Kaiser/HRET Survey of Employer-Sponsored Health Benefits, the percentage of large firms that offered retiree benefits in 2008 was 31%.<sup>43</sup> This represents a significant decline from the 66% of large firms that offered retiree benefits in 1988.<sup>44</sup> Virtually all of the large firms that offer retiree health benefits offer them to early retirees under the age of 65 (94%).<sup>45</sup> Only 77% of those employers offer them to Medicare-age retirees.<sup>46</sup> “In 2006, ‘about 10 million retirees ages 55–64 have health coverage through their former employer. Furthermore, 13 million individuals ages 65 and older have some form of employment-based health benefits—either as an active worker or a retiree.’”<sup>47</sup> A recent study by Watson Wyatt and the National Business Group on Health, however, indicates that only 18% of those companies that provide health benefits for retirees do so for new hires.<sup>48</sup> Times have changed.

The cost of health care has been the catalyst for this change.<sup>49</sup> In 2008, the average annual employer-sponsored health insurance premium for single coverage was \$4,704 and for family coverage \$12,680, which is a 5% increase from 2007.<sup>50</sup> This represents a

43. The Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2008 Annual Survey* 162 (2008) (available at <http://ehbs.kff.org/pdf/7790.pdf>) [hereinafter *2008 Survey*]. The percentage quoted here represents large firms (200 or more workers) that offer health benefits to their employees. This percentage also reflects a decline from 2006 where the number of large employee offering retiree benefits was 35%. The Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2006 Annual Survey* 132 (2006) (available at <http://www.kff.org/insurance/7527/upload/7527.pdf>) [hereinafter *2006 Survey*]. Among firms that offer health benefits, 31% of large firms offer benefits to retirees, compared to just 4% of small firms (3–199 workers). *2008 Survey*, *supra* n. 43, at 162. Unionized large firms are much more likely to provide their retirees with health benefits—46% versus 24% for all large firms with no union employees. *Id.*

44. *2008 Survey*, *supra* n. 43, at 162.

45. *Id.* This could be significant, for example, if the company chooses to terminate the retiree benefits. This early retiree would be ineligible for Medicare and could be without health insurance. Overall, “early-retiree medical coverage is becoming increasingly rare, with just 27 percent of large employers still offering it to new hires, down from 46 percent 15 years ago.” Mercer Consulting, *National Survey of Employer-Sponsored Health Plans*, <http://www.mercer.com/summary.htm?idContent=1328445> (2008).

46. *Id.* Medicare is a health insurance program administered by the United States. Citizens or permanent residents of the United States are eligible for Medicare coverage if they have worked for at least ten years and are age sixty-five or older. See Medicare, *Medicare Eligibility Tool*, <http://www.medicare.gov/MedicareEligibility/Home.asp?dest=NAV|Home|GeneralEnrollment#TabTop> (last updated Sept. 17, 2008).

47. Pratt, *supra* n. 40, at 115 (quoting Alliance for Health Reform, *Covering Health Issues 2006, Chapter 2: Private Health Coverage* 23, <http://www.allhealth.org/sourcebookcontent.asp?CHID=11> (last updated Apr. 4, 2007)).

48. *Id.* (citing Jeremy Smerd, *Retiree Health Coverage an Endangered Species*, <http://www.workforce.com/section/00/article/24/84/22.html>. (Apr. 4, 2007)).

49. “Total health care spending, which consumed about 8 percent of the U.S. economy in 1975, currently accounts for about 16 percent of GDP, and that share is projected to reach nearly 20 percent by 2016.” Peter R. Orszag, Director, Cong. Budget Off., *Statement Before the Committee on the Budget, United States Senate Health Care and the Budget: Issues and Challenges for Reform*, (June 21, 2007) (available at <http://www.cbo.gov/ftpdocs/82xx/doc8255/06-21-HealthCareReform.pdf>). One small business owner commented that “his health insurance premiums had risen by 22 percent a year in the last four years. He now pays \$4,150 a month in health insurance premiums for his 33 employees, and the workers contribute an equal amount from their own pockets.” Eduardo Porter et al., *Rising Cost of Health Benefits Cited As Factor in Slump of Jobs*, <http://www.nytimes.com/2004/08/19/business/19care.html?pagewanted=1> (Aug. 19, 2004).

50. *2008 Survey*, *supra* n. 43, at 1. In 2008, the average annual employee contribution toward single coverage was \$721 and toward family coverage was \$3,354. *Id.* In addition to these contributions toward the premium, the majority of employees (68%) must contribute to the cost of the covered healthcare service. *Id.* at 1–3.

119% increase over the average premiums in 1999.<sup>51</sup> Furthermore, a recent study found that total health plan costs per employee rose by 6.3% in 2008 and is expected to rise by 6.4% in 2009.<sup>52</sup> The outlook for retiree health benefits is even bleaker.

What was once a “throw away benefit,” has morphed into what one commentator has termed “the proverbial money pit.”<sup>53</sup> Annual costs per retiree will increase by an average of \$719 per year, which is a 6% increase in 2008 over 2007.<sup>54</sup> Average annual cost increases for retirees over the age of 65 have been volatile over the last 8 years—24% in 2000, 18% in 2001, 19% in both 2002 and 2003, 13% in 2004, 9% in 2005, 6% in 2006, and 8% in 2007.<sup>55</sup>

Retirees will feel the pain of this “throw away benefit” in their wallet more now than ever. Retirees under the age 65 will contribute 50% of the annual premium for individual coverage and 52% for family coverage.<sup>56</sup> In dollar terms, these retirees will pay an average of \$3,396 per year for individual coverage and \$7,020 for themselves and one dependent.<sup>57</sup> Not only will retirees pay more for premiums, but according to a recent survey, 32% of employers surveyed 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.<sup>58</sup> If this trend of rising healthcare costs continues as expected, the issue of affordability will become more challenging for retirees, companies, and everyone else.

### III. ERISA, EMPLOYERS, AND RETIREES

#### A. *The Plight of the Retiree*

Retirees are in serious trouble. When retiree benefits were first offered by employers, there were far more active employees contributing to the cost of providing employer health benefits for retirees.<sup>59</sup> For example, in 1970 the ratio of active employees to retirees was 16-to-1.<sup>60</sup> By 1990, however, the ratio had declined to 4-to-1 and is expected to reach 2-to-1 within the next 20 years.<sup>61</sup> For some companies, the ratio is already near those levels. GM, for example, reports that it has 2.5 retirees for every active worker.<sup>62</sup> This equates to more than \$5.2 billion in retiree health care costs per

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51. *Id.* Employee contributions in 2008 represent a 117% increase above the contributions in 1999. *Id.*

52. Mercer Consulting, *supra* n. 45.

53. See Keating, *supra* n. 40, at 987.

54. 2008 Survey, *supra* n. 43, at 1.

55. *Id.* at 3. According to a recent survey, 74% of employers surveyed increased retiree premiums in 2006. 2006 Survey, *supra* n. 43, at 20 ex. 17.

56. 2008 Survey, *supra* n. 43, at 4.

57. *Id.* The contributions are not as severe (and the coverage is not as significant because they are also eligible for Medicare) for retirees over age 65. They would pay an average of \$1,632 annually for individual coverage and \$3,312 for retiree and one dependent. *Id.*

58. 2006 Survey, *supra* n. 43, at 20 ex. 17.

59. One commentator notes that this phenomenon is clear by examining the Social Security crisis. He states, “Fewer active employees are at work to generate employee benefit contributions to supply benefits to an ever-increasing number of retirees.” James P. Baker et. al., *Retiree Medical Litigation’s Dirty Little Secret—“Location, Location, Location!”* 22 Benefits L. J. 26, 26 (Spring 2009).

60. *Id.*

61. *Id.*

62. Larry Grudzien, *The Great Vanishing Benefit, Employer Provided Retiree Medical Benefits: The*



year.<sup>63</sup> For GM and employers with similar financial difficulties, to remain going concerns, they must find ways to cut costs.<sup>64</sup>

One of those ways is to cut retiree benefits either by eliminating them completely or by reducing the benefits. Retirees, of course, are resistant to this cost cutting mechanism and fight it. Many hurdles, however, stand in their way. First, retirees are not similarly situated to active employees because they lack leverage—all of their contributions to the employer occurred in the past.<sup>65</sup> Second, retirees are particularly vulnerable when a labor contract is involved.<sup>66</sup> They lack voting power and the costs of retiree benefits have been a key issue in labor negotiations in recent years. Finally, two of the more daunting and formalistic hurdles, which I explore further below, are vesting and pre-funding.

### B. ERISA

Under ERISA, there are two types of plans—employee welfare benefit plans (welfare plans) and employee pension benefit plan (pension plans).<sup>67</sup> Although ERISA technically regulates both pension plans and welfare plans, it excludes welfare plans from two provisions that are relevant to providing retirees with benefits—vesting and pre-funding.<sup>68</sup> This dichotomy helps to explain part of the reason that retirees are facing retirement with reduced or no benefits.

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*Problem and Possible Solutions*, 39 John Marshall L. Rev. 785, 794 (2006) (citing Tom Walsh, *GM's CEO Must Cope with Retiree Benefit Cost*, Detroit Free Press (Apr. 20, 2005)).

63. See *id.* Healthcare costs for active and retirees add \$1,500 to the price of every car GM produces. *Id.* Smaller employers are feeling the effect of retiree benefit costs as well. For example, the Maytag Corporation, with 18,000 active employees, is facing retiree benefit costs of \$60 million per year. *Id.* For Maytag, the number of retirees increased by 25% from 2000 to 2004. *Id.*

64. GM reports that in 2008, its total hourly labor cost was \$69. Mark Perry, *More on Total Hourly Labor Costs: GM vs. Toyota*, <http://www.dailymarkets.com/stocks/2008/11/24/more-on-total-hourly-labor-costs-gm-vs-toyota> (Nov. 24, 2008). The total hourly rate includes wages of "\$29.78 per hour, plus benefits, pensions and the cost of providing health care to more than 432,000 GM retirees." *Id.* Toyota, one of GM's fiercest foreign competitors, only spends \$48 per hour on total labor costs. *Id.*

65. Daniel Keating, *Harsh Realities and Silver Linings for Retirees*, 15 Am. Bankr. Inst. L. Rev. 437, 437 (2007). An active employee could threaten a strike to negotiate for additional benefits. *Id.*

66. *Id.* at 437–438.

67. See ERISA, § 3(1); 3(2)(A). ERISA defines an "employee welfare benefit plan" as:

any plan . . . established or maintained by an employer [or] by an employee organization . . . , for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services . . . .

*Id.* ERISA defines an "employee pension benefit plan" as:

any plan, fund, or program which was . . . established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—(A) provides retirement income to employees, or (B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond.

*Id.* at § 3(2)(A).

68. See *id.* at §§ 203, 301.

### 1. Vesting

In 1970, pension plans covered more than forty million employees.<sup>69</sup> Adverse experiences often threatened the very existence of the pension and whether the pension benefits would actually be paid.<sup>70</sup> For example, vesting<sup>71</sup> provisions were often impossible to attain because employers would terminate the employees days before their pension vested.<sup>72</sup> Congress, therefore, enacted ERISA in part to eliminate this problem by imposing strict vesting requirements for pensions.<sup>73</sup> Congress, however, did not impose vesting requirements for welfare plans. This means that ERISA does not require employers to continue to pay for welfare benefits in retirement unless the employer chooses to vest the benefits or the employer specifically does something that vests the benefits. Whether benefits are vested, therefore, can become a question of fact for courts.

Federal courts have adopted a contractual approach to the question of whether retirees are vested in their benefits—“what, if anything, did the employer promise, and what (if any) limitations did the employer place on the scope and duration of the promise.”<sup>74</sup> Retiree challenges to vesting generally arise in one of two ways. Either (1) the employee reaches the normal retirement age, usually 65 years of age, and retires, becoming entitled to receive the benefits identified under the terms of the employer’s plan, or (2) the employer offers an early retirement program, including retiree health benefits, and the employee accepts the offer.<sup>75</sup> In either case, the retiree seeks to challenge the employer’s modification or termination benefits.

The evidence in these cases is generally the information contained in the plan document, the summary plan description,<sup>76</sup> any written materials given to retirees, and oral presentations on retiree benefits.<sup>77</sup> The issue in these cases is usually whether the employer reserved the right to amend the terms of the plan and if that right was communicated to the employee.<sup>78</sup> Generally, the principle that holds in these cases is that the employer is free to terminate or reduce retiree benefits if the employer expressly retains the right in the plan to do so.

In *Sprague v. General Motors Corporation*,<sup>79</sup> a class of 50,000 early retirees sued

69. David Gregory, *The Scope of ERISA Preemption of State Law: A Study in Effective Federalism*, 48 U. Pitt. L. Rev. 427, 443 (1987).

70. *Id.*

71. ERISA defines a vested pension as one where “an employee’s rights in his accrued benefit derived from his own contributions are nonforfeitable” or where an employer contributes to the plan, an employee is vested when he has worked for the employer for five years. ERISA, § 203(a)(1). The United States Court of Appeals for the Sixth Circuit states that “[t]o vest benefits is to render them forever unalterable.” *Sprague v. Gen. Motors Corp.*, 133 F.3d 388, 400 (6th Cir. 1998).

72. *Id.* at 443–444.

73. See ERISA, § 203.

74. Pratt, *supra* n. 40, at 138; see e.g. *UAW v. Yard-Man, Inc.*, 716 F.2d 1476 (6th Cir. 1983); *Alday v. Container Corp.* 906 F.2d 660 (11th Cir. 1990).

75. Pratt, *supra* n. 40, at 138.

76. ERISA requires employers to provide employees with a summary plan description. ERISA, § 102(a)(1). “The summary plan description shall . . . be written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan.” *Id.*

77. Pratt, *supra* n. 40, at 139.

78. *Id.*

79. 133 F.3d 388.

after their former employer, GM, amended its plan and required retirees to pay an annual deductible and co-payment which GM had previously paid.<sup>80</sup> At issue in this case was the apparent ambiguity between the language in the summary plan description and that in the plan document itself.<sup>81</sup> The summary plan description went through several editions over the years but generally provided as follows: “Your basic health care coverages will be provided at GM’s expense for your lifetime.”<sup>82</sup> The summary plan description also provided: “General Motors believes wholeheartedly in this Insurance Program for GM men and women, and expects to continue the Program indefinitely. However, GM reserves the right to modify, revoke, suspend, terminate, or change the Program, in whole or in part, at any time . . . .”<sup>83</sup> The plaintiffs argued that some editions of the summary plan descriptions did not clearly state that GM could amend or terminate the plan.<sup>84</sup> The court looked to the plan document in that case, where it clearly stated that GM could amend the plan.<sup>85</sup> The promise of lifetime benefits in this case was basically a qualified promise—you have benefits for life until we amend the plan.

Cases involving the question of lifetime vesting of benefits and retiree challenges to employer amendments to benefit plans have come out both ways.<sup>86</sup> The outcomes of the cases do not turn on any difference in the legal standard stated above. Instead, the differences in outcome depend on “subtle distinctions among circuits in interpreting what are, at least on the surface, the same legal standards for vesting.”<sup>87</sup> Litigants fare better in the United States Court of Appeals for the Sixth Circuit than in any other circuit.<sup>88</sup> Getting over this vesting hurdle provides the retiree with some hope that he will receive benefits for life; the employer, however, must have money to pay for the benefits.

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80. *Id.* at 395.

81. *Id.* at 401.

82. *Id.* at 394 (quoting GM’s 1977 version of the summary plan description entitled “Your Benefits in Retirement”).

83. *Id.* at 394 (quoting GM’s 1965, 1968, and 1971 versions of the summary plan description entitled “The General Motors Insurance Program for Salaried Employees”). The 1985 version of the summary plan description provided, “The Corporation reserves the right to amend, modify, suspend, or terminate its benefit Plans or Programs by action of its Board of Directors.” *Sprague*, 133 F.3d at 394.

The plaintiffs also argued in this case that GM executed bilateral contracts with each of the retirees when the company promised the lifetime benefits through the early retirement program. *Id.* at 402–404. The plaintiffs stated that the agreement to accept early retirement indicated lifetime benefits, which was reinforced orally at an exit interview or oral presentation to a group of early retirees. *Id.* The court maintained that “ERISA requires that every plan ‘shall be established and maintained pursuant to a written instrument.’” *Id.* at 402 (quoting ERISA, § 402(a)(1)).

84. *Id.* at 402–404.

85. *Sprague*, 133 F.3d at 402–404.

86. Daniel Keating, *Bankruptcy Code § 1114: Congress’ Empty Response to the Retiree Plight*, 67 Am. Bankr. L. J. 17, 26 (1993); compare *Senn v. United Dominion Indus.*, 951 F.2d 806 (7th Cir. 1992) (finding that benefits were not vested) with *Smith v. ABS Indus.*, 890 F.2d 841 (6th Cir. 1989) (finding that benefits were vested).

87. Keating, *supra* n. 86, at 26–27.

88. *Id.* For a thorough discussion of the legal standards and interpretations used by the various circuit courts, see Baker et. al., *supra* n. 59, at 34–42.

## 2. Pre-funding

### a. *The Deferred Maintenance Problem*

At the end of 1957, the Studebaker-Packard Corporation pension trust had \$9.6 million in assets—a rather sizeable sum for those days.<sup>89</sup> The problem, however, was that the company had a liability for retirement benefits that totaled \$27 million.<sup>90</sup> In 1963, the Studebaker-Packard Corporation lacked the assets to meet its pension plan obligations and, as a result, shut down its plant in South Bend.<sup>91</sup> The corporation's lack of pre-funding for future payments of benefits and the public outcry that followed the company's failure to pay the benefits compelled Congress to enact ERISA and impose stringent pre-funding requirements for pension plans.<sup>92</sup> Congress, however, exempted welfare benefits from the pre-funding requirements as it had for the vesting requirements.<sup>93</sup>

Instead of pre-funding, companies treat retirement medical benefit costs on a “pay-as-you-go basis—companies pay the insurance premium or, if there is no insurer, they pay claims as they occur.”<sup>94</sup> The corporate mindset behind the pay-as-you-go theory was: “if they were allowed to postpone a bill, then why not do so?”<sup>95</sup> After all, from the employer's perspective, that was the beauty of retiree medical benefits—cash on hand could be used to pay current liabilities such as compensating employees and paying suppliers and to fend off competition, not to pre-fund benefits that would not be paid until the future.<sup>96</sup> The problem with this mindset, which Professor Keating has termed the “deferred maintenance problem,” is here for a lot of companies.<sup>97</sup> That problem is how to pay for the retiree medical benefits now that employees are retiring in droves.<sup>98</sup>

The “deferred maintenance problem” came to the forefront for the public most notably when LTV Steel Company (LTV) filed for chapter 11 bankruptcy in 1986.<sup>99</sup> Following the filing, LTV announced that it was terminating its health benefit plan for 78,000 retirees and their dependents.<sup>100</sup> Within two days, the United States Senate passed a bill ordering LTV to reinstate benefits and later enacted § 1114 of the Bankruptcy Code to protect retirees.<sup>101</sup> Although this protection is available for companies in bankruptcies, the LTV example illustrates what could happen to a large number of retirees when companies, which are not in bankruptcy, fail to pre-fund

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89. James A. Wooten, “*The Most Glorious Story of Failure in the Business*”: *The Studebaker-Packard Corporation and the Origins of ERISA*, 49 *Buff. L. Rev.* 683, 710 (2001).

90. *Id.*

91. *Id.*

92. Keating, *supra* n. 40, at 988; see ERISA, §§ 301–305.

93. ERISA, § 301.

94. D. Gerald Searfoss & Naomi Erickson, *The Big Unfunded Liability: Postretirement Healthcare Benefits*, *J. of Accountancy* 28, 29 (Nov. 1988).

95. Keating, *supra* n. 86, at 23.

96. Keating, *supra* n. 40, at 987.

97. *Id.*

98. *Id.*

99. See Susan J. Stabile, *Protecting Retiree Medical Benefits in Bankruptcy: The Scope of Section 1114 of the Bankruptcy Code*, 14 *Cardozo L. Rev.* 1911, 1926 (1993).

100. *Id.*

101. *Id.*

benefits and fail to vest them in their retirees. This provision of the Bankruptcy Code is discussed in greater detail in Part V.

*b. Accounting Rules*

As explained above, companies once considered retiree benefits a “throw away benefit” because they were essentially immaterial cost wise. As a result, few employers actually tracked or analyzed them.<sup>102</sup> Moreover, because companies rarely pre-funded the retiree medical benefits, they were accounted for on a cash basis—companies recognized the current benefits paid, but only included the existence of possible future liabilities in a footnote in their financial statements.<sup>103</sup> In essence, the possibility of a large financial cash outlay in the future had no effect on the bottom line in the present. As the cost of healthcare soared in the 1980s, this unfunded liability became much more significant.<sup>104</sup> Consequently, in 1990, the Financial Accounting Standards Board (FASB) adopted Financial Accounting Standard 106 (SFAS 106), entitled “Employers’ Accounting for Postretirement Benefits Other Than Pensions.”<sup>105</sup>

SFAS 106 significantly changed the rules governing the accounting for retiree medical benefits. Instead of recording postretirement benefits on a pay-as-you-go cash accounting basis, SFAS 106 required companies to accrue (during the working lives of the employees) and report in the financial statements the expected cost of providing benefits during retirement.<sup>106</sup> While this accrual was significant for active employees, it translated into astronomical numbers for retirees.<sup>107</sup>

102. Frolik & Moore, *supra* n. 17, at 115.

103. *Id.*

104. *Id.* Before offloading its retiree medical benefit into a VEBA, General Motors’ unfunded retirement benefit plan was the largest accrued by any corporation. Geisel, *supra* n. 16; see also Mark Bruno & Jenna Gottlieb, *A Bird? A Pension Plan? No, It’s a VEBA*, 35 Pensions & Invs. 1 (Oct. 1, 2007). From 2000 to 2004, GM’s unfunded retiree medical benefit obligations increased from \$42 billion to \$67.6 billion. Keating, *supra* n. 65, at 462. GM expected its accumulated unfunded liability for retiree medical benefits to increase 22% between 2005 and 2009. *Id.*

105. Frolik & Moore, *supra* n. 17, at 115. SFAS 106 has an effective date of December 15, 1992. *Id.*; see FASB, *Statement 106: Employers’ Accounting for Postretirement Benefits Other Than Pensions*, <http://www.fasb.org/pdf/fas106.pdf> (Dec. 1990). The Financial Accounting Standards Board promulgated SFAS 106 in part because of medical inflation, where in the late 1980 it was between fifteen and twenty percent. Martin Feldman & Roscoe Haynes, *Effect of New GASB 45 Accounting Rules: What We Can Learn From FAS 106, Benefits & Compensation* Dig. 13 (Mar. 20, 2007).

106. FASB, *supra* n. 105. When FASB promulgated SFAS 106, relatively few companies accrued for post-retirement benefits; one survey estimated the number at 4%. Murray H. Goldstein & Murray S. Akresh, *Postemployment Benefits: The Controversy over Accrual Accounting*, 19 Comp. & Benefits. Rev. 68, 69–70 (1987).

In 2004, the Governmental Accounting Standards Board (GASB) promulgated a similar statement, GASB Statement No. 45. Frolik & Moore, *supra* n. 17, at 115. This statement requires governmental employers to recognize retiree medical benefits on an accrual basis instead of a cash basis. *Id.* Unfunded retiree benefit liabilities for government employers were estimated at \$1.5 trillion. *Id.*

GASB Statement No. 45 will likely have a significant effect on retiree benefits for governmental institutions. In a recent survey of 185 higher education institutions, TIAA-CREF found that 76% offered retiree benefits. Grudzien, *supra* n. 62, at 789 (citing Paul Fronstein & Paul Yakoboski, *TIAA-CREF Institute Policy Brief, Options and Alternatives to Fund Retiree Health Care Expenditures 2*, <http://www.tiaa-crefinstitute.org/articles/pol070105.html> (July 2005)). Of those institutions, 12% indicated that they would likely discontinue offering retiree benefits. *Id.*

107. Feldman & Haynes, *supra* n. 105, at 20. When FASB promulgated SFAS 106, studies indicated that unreported retiree benefits amounted to between \$100 billion and \$2 trillion nationwide. Goldstein & Akresh, *supra* n. 106, at 69; Geisel, *supra* n. 16.

When FASB promulgated SFAS 106, companies had a choice to either (1) report the unfunded retiree benefit liability in a one-time charge, or (2) report the liability through annual expense charges over 20 years.<sup>108</sup> Several companies chose to book the liability immediately. For example, GM eliminated three-fourths of its net worth by booking expenses totaling \$20.8 billion.<sup>109</sup> Other companies recorded the following SFAS 106 expenses: IBM \$33.2 billion, Ford \$7.5 billion, Chrysler \$4.7 billion, and AT&T \$6.6 billion.<sup>110</sup>

While SFAS 106 forced companies to recognize the current value of retiree medical benefits, it did nothing to force companies to pre-fund retiree medical benefits.<sup>111</sup> Instead, according to companies, SFAS 106 reduced the availability of benefits for retirees. Mercer Consulting reports that in the seven-year period following SFAS 106's enactment, large companies offering medical benefits to early retirees declined from 46% in 1993 to 29%.<sup>112</sup> Over the same time period, "Medicare-eligible retirees saw their probability of receiving retiree medical benefits drop from 40% to 23%."<sup>113</sup> For companies, SFAS 106 caused a large expense to hit the financial statements; for retirees SFAS 106 caused the likelihood of receiving benefits in retirement to significantly decline.

To assist employers in dealing with their retiree medical benefit costs, in 2003 Congress passed and President George W. Bush signed into law the Medicare Prescription Drug Improvement and Modernization Act.<sup>114</sup> The Act allows employers and unions to receive subsidies for the purpose of maintaining prescription drug coverage for their retirees.<sup>115</sup> For 2006 the subsidy equaled 28% of allowable drug costs between \$250 and \$5000 (indexed in later years) for each retiree.<sup>116</sup> To receive the subsidy, the employer or union must attest that the coverage is of equal or greater actuarial value to the Medicare Part D drug benefit.<sup>117</sup>

Excluding recent government loans to corporations, this subsidy is the first assistance employers have received in dealing with the retiree medical benefit crisis.<sup>118</sup> Retirees, however, are still very much at risk—SFAS 106 did nothing to encourage pre-funding of retiree medical benefits; companies are experiencing dire financial conditions because of the exorbitant number of retirees and the high cost of healthcare; ERISA does not require pre-funding of welfare benefits; and ERISA does not require vesting of

108. Pratt, *supra* n. 40, at 121.

109. *Id.*

110. *Id.*

111. *See generally id.*

112. J.P. Morgan, *But, You Promised! Why the Future of Employer Provided Retiree Medical Coverage is Bleak*, [http://www.jpmorgan.com/cm/cs?pagename=JPM\\_redesign/JPM\\_Content\\_C/Generic\\_Detail\\_Page\\_Template&cid=1159308441478&c=JPM\\_Content\\_C](http://www.jpmorgan.com/cm/cs?pagename=JPM_redesign/JPM_Content_C/Generic_Detail_Page_Template&cid=1159308441478&c=JPM_Content_C) (May 11, 2005).

113. *Id.*

114. Medicare Prescription Drug, Improvement and Modernization Act of 2003, Pub. L. No. 108-173, 117 Stat. 2066 (2003).

115. *Id.*

116. *Id.*

117. *Id.*

118. *See* Grudzien, *supra* n. 62, at 787. According to the Kaiser/Hewitt 2005 Survey on Retiree Health Benefits, 82% of the employers surveyed intended to apply for the subsidy. *Id.* Estimates indicated that the average annual savings per retiree for those employers would be \$644. *Id.*

welfare plans. As a result, companies are exploring innovative ways to save retiree medical benefits while simultaneously cutting costs. One of those innovative ways is funding benefits through a VEBA.

*c. VEBAs*

Professor Keating described the past and present landscape of retiree medical benefits best:

Let me start by comparing the old world of retiree medical benefits with the current trend. Under the old-world approach, a company would make unlimited and grandiose promises of retiree medical benefits for life, with no premiums or deductibles for covered retirees. With this approach, the employer would not put aside any money today to cover the promises to which it was binding itself for the future. The new approach to retiree medical benefits is that a company makes a predetermined contribution of cash, stock, or some combination of the two to a VEBA that then becomes the sole source of a retiree's entitlement to health benefits beyond whatever Medicare would give the retiree. The VEBA-covered medical benefits are almost invariably a lot more modest than the unfunded promises the employer would be making under the old approach.<sup>119</sup>

Companies that are funding retiree medical benefits through a VEBA are using a relatively unknown provision of the IRC to effect big changes for the company and the retirees. Understanding VEBAs, therefore, is key to analyzing whether the VEBA is a win-win.

*A. VEBAs-IRC § 501(c)(9)*

VEBAs are organizations that are exempt from taxation under IRC § 501(a).<sup>120</sup> The Code treats a VEBA as tax exempt if a trust or other separate tax entity meets the following requirements:

Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.<sup>121</sup>

At first blush, the statutory language seems relatively easy to understand—four items are required: (1) a voluntary association of employees; (2) the purpose of the association must be to pay life benefits, sick benefits, or other benefits; (3) the association must pay those acceptable benefits to members and their designated beneficiaries; and (4) the net earnings must not benefit any individual or private shareholder.<sup>122</sup> To adopt a VEBA, companies must consider the language of the statute and address other concerns. For example, who qualifies as an employee?<sup>123</sup> Under what

119. Keating, *supra* n. 65, at 460.

120. I.R.C. § 501(c)(9).

121. *Id.*

122. *Id.*; Treas. Reg. § 1.501(c)(9)-1 (issued Aug. 17, 2006); see also David S. Dunkle, *VEBAs and Other Self-Insured Arrangements in Tax Management Portfolios A-15* (BNA 1993); John J. Koresko & Jennifer S. Martin, *VEBAs, Welfare Plans, and Sec. 419(f)(6): Is the IRS Trying to Regulate or Spread Propaganda?* 32 Sw. U. L. Rev. 1, 18 (2003).

123. Dunkle, *supra* n. 122, at A-15.

conditions is membership in an association “voluntary?”<sup>124</sup> Do all legal entities qualify as associations?<sup>125</sup> “What is the meaning of the terms ‘life,’ ‘sick,’ ‘accident,’ and ‘other benefits?’”<sup>126</sup>

Beyond the ambiguity in the words of the statute, the interrelationship between the VEBA statute and other tax statutes adds additional complexity.<sup>127</sup> For example, IRC §§ 419 and 419A limit the yearly amount that a company can deduct for its contributions to a VEBA.<sup>128</sup> In addition, there are intricate rules for nondiscrimination<sup>129</sup> testing for the VEBA membership found in IRC § 505.<sup>130</sup> Finally, the Internal Revenue Service (IRS) and ERISA subject the VEBA to documentation and reporting requirements.<sup>131</sup>

## B. Resolving Statutory Ambiguities

### 1. Member of a Voluntary Association of Employees

The Treasury Regulations dispel some of the ambiguity in the language of the VEBA statute. First, what does it mean to be a member of voluntary association of employees? This characteristic of a VEBA has four distinct elements: (1) membership, (2) that is voluntary, (3) in an association, (4) of employees.

#### a. Membership

To be eligible as a member of a VEBA, individuals must be employees.<sup>132</sup> The Regulations, however, consider the association to consist of only employees if “90 percent of the total membership of the association on one day of each quarter of the association’s taxable year consists of employees” within the meaning of employee as this article later discusses.<sup>133</sup> Therefore, individuals other than employees may be members of the association if they share an employment related bond with the employee-members and they make up less than 10% of the total membership.<sup>134</sup> For example, an association may include as part of this 10% the business owner whose employees are members and who make up the other 90% of the total population of the association.<sup>135</sup> All members of the association, not just the non-employee members, however, must share an employment related bond with each other based on an objective standard of all the facts

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. See I.R.C. §§ 419, 419A.

129. Generally, the term “nondiscrimination” in this sense means that VEBA benefits cannot favor highly paid employees. See Anne E. Moran, *VEBAs: Possibilities for Employee Benefit Funding*, 29 Employee Rel. L. J. 83, 85 (2003) (discussing VEBA coverage and nondiscrimination rules); Koresko & Martin, *supra* n. 122, at 27.

130. See I.R.C. § 505.

131. See ERISA, 29 U.S.C. §§ 101, 103; I.R.S., *Form 1024* (1998) (available at <http://www.irs.gov/pub/irs-pdf/f1024.pdf>); I.R.S., *Form 5500* (2008) (available at <http://www.irs.gov/pub/irs-pdf/f5500.pdf>); Koresko & Martin, *supra* n. 122, at 20 (discussing ERISA requirements pertaining to a VEBA).

132. Treas. Reg. § 1.501(c)(9)-2(a)(1).

133. *Id.*; see also I.R.M. 7.20.4-7 (2006) (available at <http://www.irs.gov/irm/part7/36938015.html>) (describing the membership requirements of a VEBA).

134. Treas. Reg. § 1.501(c)(9)-2(a)(1).

135. *Id.*



and circumstances.<sup>136</sup>

The Regulations provide that members will have an employment-related common bond under several scenarios. The members could have a common employer or affiliated employers, could be covered under a collective bargaining agreement, or could have membership in the same labor union.<sup>137</sup> For example, association membership may be open to all employees of a particular company or perhaps just to employees of a specified job classification or specified location covered by a union agreement.<sup>138</sup> The Regulations also define an employment-related bond to exist when individuals who are employees of one or more employers “engaged in the same line of business in the same geographic locale” form an association.<sup>139</sup> Proposed Treasury Regulations define the term “same geographic locale” using a three-state safe harbor.<sup>140</sup> The safe harbor indicates that “[a]n area is a single geographic locale . . . if it does not exceed the boundaries of three contiguous states, i.e., three states each of which shares a land or river border with at least one of the others.”<sup>141</sup> In addition to these scenarios, the Regulations also indicate that associations may restrict membership based on other objective criteria, such as reasonable worker classifications, reasonable minimum service requirements, or to full-time employees only.<sup>142</sup>

#### b. *Voluntary*

The Regulations indicate that membership in an association is voluntary if the employer requires an affirmative act by the “employee to become a member rather than the designation as a member due to employee status.”<sup>143</sup> For example, an affirmative act would include an employee signing an enrollment form for employer-provided health insurance. The Regulations deem an association voluntary, however, even if the employer requires all employees to be members, as long as there is no detriment to the employee.<sup>144</sup> A detriment to an employee that would render the membership involuntary would include a deduction from an employee’s pay for the benefits gained from being a member of the association.<sup>145</sup> A membership is not involuntary, however, if an employee union and employer agree to membership under a collective bargaining agreement or as an incidence of union membership.<sup>146</sup>

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136. *Id.*

137. *Id.*; see also I.R.M. 7.20.4-7 (describing the membership requirements of a VEBA); Dunkle, *supra* n. 122, at A-16 (same).

138. Treas. Reg. § 1.501(c)(9)-2(a)(1).

139. *Id.*; see also I.R.M. 7.20.4-7 (describing the membership requirements of a VEBA); Dunkle, *supra* n. 122, at A-16 (same).

140. See Prop. Treas. Reg. § 1.501-(c)(9)-2(d), 57 Fed. Reg. 34886-02.

141. *Id.*; but see *Water Quality Assn. Employees’ Benefit Corp. v. U.S.*, 795 F.2d 1303 (7th Cir. 1986) (holding that the geographic locale restriction is invalid).

142. Treas. Reg. § 1.501(c)(9)-2(a)(2)(i).

143. *Id.* at § 1.501(c)(9)-2(c)(2).

144. *Id.*

145. *Id.*; see also I.R.M. 7.20.4-7 (describing the voluntary membership requirements of a VEBA).

146. Treas. Reg. § 1.501(c)(9)-2(c)(2); see also I.R.M. 7.20.4-7 (describing the voluntary membership requirements of a VEBA).

c. *An Association*

To be an association for VEBA purposes, an entity must have an existence separate and independent from the member-employees or their employer. An employer, therefore, can organize an association as a corporation or as a trust.<sup>147</sup> In early times, associations organized as corporations complete with articles of incorporation and bylaws.<sup>148</sup> In modern times, however, employers have simply created associations using an employee benefit plan coupled with a trust agreement.<sup>149</sup>

d. *Of Employees*

The term “of employees” has two subparts—control and the meaning of “employee.”

i. Control

To qualify as a VEBA, the association must consist of employees who are in control. To accomplish the control requirement, the members can (1) control the association directly, (2) appoint an independent trustee such as a bank, or (3) elect trustees or other fiduciaries to act on the membership’s behalf.<sup>150</sup> The Regulations also deem the members to control the association if a collective bargaining agreement designates a trustee for the benefit plan.<sup>151</sup> In addition, the Regulations consider an association “to be controlled by an independent trustee if it is an employee welfare benefit plan” and is subject to ERISA.<sup>152</sup>

To have this deemed control status, a plan must meet parts 1 and 4 of subtitle B, title I of ERISA.<sup>153</sup> These parts subject VEBAs to the documentation and disclosure requirements of ERISA.<sup>154</sup> ERISA generally requires a welfare benefit plan to have

a written plan document that is sufficiently complete so that for each benefit offered, a reader can determine which persons are eligible recipients, what conditions trigger the payment or distribution of the benefit, whether and to what extent employees are offered the benefit upon different conditions, and how the amount of the benefit is calculated or determined.<sup>155</sup>

If it meets these requirements, the Code deems the VEBA controlled by an independent trustee.

147. Treas. Reg. § 1.501(c)(9)-2(c)(2); *see also* Dunkle, *supra* n. 122, at A-20 (describing the meaning of “association”).

148. Dunkle, *supra* n. 122, at A-20.

149. *Id.* (describing the meaning of “association”).

150. Treas. Reg. § 1.501(c)(9)-2(c)(3); *see also* Dunkle, *supra* n. 122, at A-20–A-21 (describing the control requirement); Moran, *supra* n. 129, at 85–86 (describing the control requirement); *Am. Assn. of Christian Schs. Voluntary Employees Beneficiary Assn. Welfare Plan v. U.S.*, 663 F.Supp 275, 279 (M.D. Ala. 1987) (holding that a VEBA must be controlled by members or an independent trustee appointed by members).

151. Treas. Reg. § 1.501(c)(9)-2(c)(3)(iii).

152. *Id.* (emphasis in original).

153. *Id.*

154. ERISA, §§ 101, 503.

155. Koresko & Martin, *supra* n. 122, at 20 (describing the ERISA Requirements).

## ii. Meaning of “Employee”

The second subpart of the term “of employees” is the meaning of employee. Treasury Regulations provide that “whether an individual is an employee is determined by reference to the legal and bona fide relationship of employer and employee.”<sup>156</sup> These Regulations, however, offer a broader definition for employee than common law, and it more closely resembles that of labor law.<sup>157</sup> An employee for these purposes includes the following: (1) an individual that the Code considers to be an employee under subtitle C or an employee for purposes of a collective bargaining agreement, (2) “[a]n individual who became entitled to membership in the association by reason of being or having been an employee,”<sup>158</sup> or (3) the surviving spouse and dependents of the employee.<sup>159</sup> “This broad definition of ‘employee’ gives VEBAs substantial leeway to provide benefits to all persons who have any reasonable employment-related common bond.”<sup>160</sup>

### 2. Life, Sick, Accident, or Other Benefits

The life, sick, accident, or other benefits provided by a VEBA “must be payable to its members, their dependents, or their designated beneficiaries.”<sup>161</sup> The Regulations define dependent to mean: (1) the VEBA member’s spouse, (2) “any child of the member or member’s spouse who is a minor or a student (within the meaning of § 151(e)(4))”, (3) any minor child living in the same home as the member, (4) or any other person described as a dependent in IRC § 151(a).<sup>162</sup> The VEBA may pay life, sick, accident, or other benefits as cash or non-cash benefits.<sup>163</sup> The Treasury Regulations help to clarify the meaning of the terms “life,” “sick,” “accident,” or “other benefits.”

#### a. Life Benefits

VEBAs that offer “life benefits” pay these benefits because of the death of the member or a dependent.<sup>164</sup> Life benefits can include direct cash payments from the VEBA to the insured or payments through an insurance contract.<sup>165</sup> The Regulations make clear, however, that “life benefits” do not include “a pension, annuity, or similar benefits, except that a benefit payable by reason of death of an insured may be settled in

156. Treas. Reg. § 1.501(c)(9)-2(b) (emphasis in original).

157. *Id.*; see also Dunkle, *supra* n. 122, at A-20 (describing the meaning of “employee”).

158. Treas. Reg. § 1.501(c)(9)-2(b)(1)–(2). These individuals include those who are on a leave of absence, working temporarily for another employer, or terminated due to retirement, disability, or layoff. *Id.* at § 1.501(c)(9)-2(b)(2).

159. *Id.* at § 1.501(c)(9)-2(b)(3).

160. Dunkle, *supra* n. 122, at A-20 (describing the meaning of “employee”).

161. Treas. Reg. § 1.501(c)(9)-3(a).

162. *Id.* Dependents under Code section 152(c)(2) could include the member’s child or descendant of a child; a brother, sister, stepbrother, or stepsister; the father or mother, or an ancestor of either, a stepfather or stepmother; a aunt or uncle; or a son-in-law, daughter-in-law, mother-in-law, father-in-law, brother-in-law, or sister-in-law. I.R.C. § 152(d). These individuals, however, can only be “dependents” if the member provides over one-half of the individual’s support and the individual did not make more than the exemption amount listed in § 151(d). *Id.*

163. Treas. Reg. § 1.501(c)(9)-3(a).

164. *Id.* at § 1.501(c)(9)-3(b). Life benefits from a VEBA can include a burial benefit or wreath in addition to cash payments or insurance. *Id.*

165. *Id.*

the form of an annuity to the beneficiary.”<sup>166</sup>

*b. Sick and Accident Benefits*

In addition to life benefits, VEBAs can offer sick and accident benefits as well. The Regulations define the term “sick and accident benefits” as “amounts furnished to or on behalf of a member or a member’s dependents in the event of illness or personal injury.”<sup>167</sup> VEBAs can pay these benefits directly to a member or dependent for amounts they expend for illness.<sup>168</sup> Similarly, VEBAs can pay sick and accident benefits as (1) premiums to a medical or health insurance program that cover sickness or accidents on the member’s behalf, (2) payments to a medical clinic, or (3) payments to “other programs under which members and their dependents are entitled to medical services or to other sick and accident benefits.”<sup>169</sup> VEBAs offering sick and accident benefits can also make payments to a member “in lieu of income during a period in which the member is unable to work due to sickness or injury.”<sup>170</sup> VEBA benefits can also come in the form of a non-cash benefit including home nursing services or transportation furnished for medical care.<sup>171</sup>

*c. Other Benefits*

Perhaps the most ambiguous language in the VEBA statute is the term “other benefits.” VEBAs can provide “other benefits;” but what does that mean? The Regulations clarify the term by providing a list of allowable other benefits and non-qualifying benefits. The Regulations state that

[t]he term other benefits includes only benefits that are similar to life, sick, or accident benefits. A benefit is similar to a life, sick, or accident benefit if: (1) It is intended to safeguard or improve the health of a member or a member’s dependents, or (2) It protects against a contingency that interrupts or impairs a member’s earning power.<sup>172</sup>

Benefits under part one of the test—benefits that employers provide to improve health—include, but are not limited to: (1) paying vacation benefits; (2) providing vacation facilities; (3) reimbursing vacation expenses; (4) subsidizing recreational activities such as athletic leagues; or (5) providing child-care facilities.<sup>173</sup> Benefits that fall under part two of the test—benefits that protect against a contingency that interrupts a member’s earning power—include, but are not limited to: (1) providing job readjustment allowances; (2) providing income maintenance payments in the event of

166. *Id.*; see also Dunkle, *supra* n. 122, at A-24 (describing “life benefits”).

167. Treas. Reg. § 1.501(c)(9)-3(c).

168. *Id.*; see also Dunkle, *supra* n. 122, at A-25 (describing “sick and accident benefits”).

169. Treas. Reg. § 1.501(c)(9)-3(c); see also Dunkle, *supra* n. 122, at A-25 (describing “sick and accident benefits”). In Revenue Ruling 66-212, the IRS ruled that other programs can include payments from a VEBA to members for premiums they paid Medicare coverage. Rev. Rul. 66-212, 1966-2 C.B. 230 (1966).

170. Treas. Reg. § 1.501(c)(9)-3(c); see also Dunkle, *supra* n. 122, at A-25 (describing “sick and accident” benefits).

171. Treas. Reg. § 1.501(c)(9)-3(c).

172. *Id.* at § 1.501(c)(9)-3(d).

173. *Id.* at § 1.501(c)(9)-3(e); see Dunkle, *supra* n. 122, at A-26 (describing “other benefits”); Walter W. Miller, *VEBAs May Be the Solution for Client’s Welfare Benefit Plans*, 7 J. Taxn. Emp. Benefits 35, 38 (May/June 1999) (describing “other benefits”).

economic dislocation; (3) paying temporary living expenses during times of disaster, such as flood or fire; (4) paying supplemental unemployment compensation benefits; or (5) paying severance benefits.<sup>174</sup> The Regulations also provide examples of benefits that do not qualify as “other benefits.” These include, but are not limited to: (1) paying commuting expenses, such as tolls or train fares; (2) providing accident or homeowner’s insurance to protect against property damage; (3) providing malpractice insurance; or (4) providing savings mechanisms for its members.<sup>175</sup>

### C. Funding the VEBA and its Deductibility

Before 1985, the Code allowed employers to deduct contributions they made to a VEBA for welfare benefits as long as the deduction satisfied the Code requirements for business expenses. IRC § 162 allows “as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.”<sup>176</sup> Treasury Regulations expand on the deductibility of certain expenses and provide that amounts paid or accrued for employee benefit plans are deductible expenses.<sup>177</sup> The contributions to and deductions allowed for a VEBA, therefore, “were effectively unlimited.”<sup>178</sup>

Consequently, VEBAs could “operate as tax-deductible accumulation vehicles without much regard to funding employees’ benefits.”<sup>179</sup> Employers, therefore, often used VEBAs for life insurance benefits because the premiums or self-funded arrangements justified large contributions to the tax-exempt entity which, in turn, justified large tax deductions.<sup>180</sup> In addition, individuals used VEBAs for “benefits” such as planes, boats, and vacation homes, instead of using VEBAs for traditional welfare benefits.<sup>181</sup> The IRS, however, was unsuccessful in challenging these abusive transactions.<sup>182</sup> Congress, therefore, amended the Code to restrict such abuses.

174. Treas. Reg. § 1.501(c)(9)-3(e); see also Dunkle, *supra* n. 122, at A-26 (describing “other benefits”); Miller, *supra* n. 173, at 38. Permissible severance benefits do not include pension benefits or deferred compensation. Treas. Reg. § 1.501(c)(9)-3(e). They only include those benefits as described in the Federal Regulations at 29 CFR 2510.3-2(b). Treas. Reg. § 1.501(c)(9)-3(e).

175. Treas. Reg. § 1.501(c)(9)-3(f); see also Dunkle, *supra* n. 122, at A-27 (describing “other benefits”).

176. I.R.C. § 162(a).

177. Treas. Reg. § 1.162-10(a). The regulation provides:

Amounts paid or accrued by a taxpayer on account of injuries received by employees and lump sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. Amounts paid or accrued within the taxable year for dismissal wages, unemployment benefits, guaranteed annual wages, vacations, or a sickness, accident, hospitalization, medical expense, recreational, welfare, or similar benefit plan, are deductible under section 162(a) if they are ordinary and necessary expenses of the trade or business.

*Id.*

178. Koresko & Martin, *supra* n. 122, at 8; see also Patrick M. Ryan, *DEFRA Requires a Current Look at VEBAs*, 15 Colo. Law. 1184 (1986) (discussing employer contributions to VEBAs deductible under liberal Code section 162); Moran, *supra* n. 129, at 86 (same).

179. Koresko & Martin, *supra* n. 122, at 8.

180. *Id.*

181. *Id.*

182. *Id.* In *Schneider v. Commr.*, Dr. Schneider prevailed when the IRS challenged his VEBA, where he had contributed \$1 million dollars to fund \$4.2 million in life insurance for himself. 63 T.C.M. (CCH) 1787 (1992). In fact, ninety-three percent of the VEBA benefits covered Dr. Schneider or his family including college education for his three children. *Id.*

### 1. Deficit Reduction Tax Act of 1984

Congress enacted the Deficit Reduction Tax Act of 1984 (DEFRA)—complex legislation designed to reduce the deficit and curb abusive tax schemes under IRC § 501(c)(9).<sup>183</sup> DEFRA added three statutes that significantly affected the VEBA. First, it added IRC § 505, which subjects all VEBAs to additional nondiscrimination requirements.<sup>184</sup> An association, therefore, can be a VEBA because it complies with the requirements of 501(c)(9), yet the Code could impose tax on it because it fails the § 505 nondiscrimination tests.<sup>185</sup> Next, DEFRA added § 419 and related § 419A, which “placed relatively severe limits on deductions allowed for contributions to all welfare benefit plans, including VEBAs.”<sup>186</sup> These Code sections effectively froze over-funded single-employer VEBAs and curtailed the use of the VEBA as a tax scheme.<sup>187</sup>

### 2. IRC §§ 419 and 419A—Deductibility Limits

Before DEFRA, employers oftentimes “pre-funded” VEBAs for future employee benefit costs and deducted the entire amount of the contributions under IRC § 162.<sup>188</sup> When and if the IRS challenged, the employer argued that they irrevocably contributed the money to the VEBA and, therefore, the Code allowed them to deduct the expense pursuant to Treasury Regulation § 1.162-10.<sup>189</sup> DEFRA imposed limitations on this practice.

IRC §§ 419 and 419A “curtail current deductions for amounts contributed to welfare benefit plans that could be used to pay future, rather than current, benefits.”<sup>190</sup> IRC § 419 provides that contributions paid or accrued to a VEBA are only deductible by an employer “if they would otherwise be deductible . . . under this section for the taxable year in which paid.”<sup>191</sup> This section allows a deduction for VEBA contributions to the extent of the “qualified cost for the taxable year.”<sup>192</sup> Qualified cost is the sum of (1) the qualified direct cost and (2) “any addition to the qualified asset account” allowed under § 419A(b) reduced by the VEBA’s after-tax income.<sup>193</sup> Qualified direct cost means the aggregate amount that the Code would have allowed as a deduction to the employer if the employer had provided the benefits directly using the cash method of accounting.<sup>194</sup> Finally, qualified asset account means “any account consisting of assets set aside to provide for the payment of (1) disability benefits, (2) medical benefits, (3) [supplemental unemployment benefits] or severance pay benefits, or (4) life insurance benefits[,]” but

183. See John J. Koresko, *VEBA Tax Advantages: VEBAs Can Reduce Taxes and Preserve Wealth*, 57 *Taxn. for Accountants* 333 (1996); Ryan, *supra* n. 178, at 1184.

184. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 513, 98 Stat. 494; see also Koresko, *supra* n. 183, at 333; I.R.C. § 505.

185. Koresko, *supra* n. 183, at 333; I.R.C. § 505.

186. Koresko, *supra* n. 183, at 333; see I.R.C. §§ 419, 419A.

187. Koresko, *supra* n. 183, at 333; see I.R.C. §§ 419, 419A.

188. Moran, *supra* n. 129, at 86 (discussing limitations on VEBA funding).

189. *Id.* (discussing limitations on VEBA funding); see also I.R.C. § 162(a); Treas. Reg. 1.162-10.

190. Koresko & Martin, *supra* n. 122, at 30.

191. I.R.C. § 419(a).

192. *Id.* at § 419(b).

193. *Id.* at § 419(c)(1)–(c)(2).

194. *Id.* at § 419(c)(3)(A).

limited to claims incurred but not yet paid.<sup>195</sup>

Through the complex language and nuances of IRC §§ 419 and 419A, a relatively simple formula for the deduction of employer contributions emerges. The Code allows an employer to deduct VEBA contributions for “benefits payable in the current tax year plus an actuarially determined amount for claims incurred but unpaid” less the VEBA’s after-tax income for the year.<sup>196</sup> Although §§ 419 and 419A impose significant limitations on the deductibility of contributions, the actuarially determined amount for claims incurred but unpaid allows for some “pre-funding” and an early deduction that can be significant.<sup>197</sup> The Code, however, has imposed tax on income “set aside” at the end of the year.<sup>198</sup>

### 3. IRC §§ 419 and 419A Exceptions

There are exceptions to the VEBA funding rules. IRC § 419A(f)(5) provides an exemption from the deduction limits for “any qualified asset account under a separate [VEBA] under a collective bargaining agreement.”<sup>199</sup> Union plans, similar to the GM and AK Steel plans discussed above, are therefore exempt under this Code section. To qualify for this exemption, “[a]t least 90% of the employees eligible to benefit must be covered by the collective bargaining agreement.”<sup>200</sup> IRC § 419A(f)(5) also exempts VBAs that have fifty or more employees and are entirely employee-funded.<sup>201</sup> In this case, there is no employer tax deduction available because the employee pays for the benefits in their entirety and there is little incentive for the employer to pre-fund.<sup>202</sup> The employee contributions, however, grow in the VEBA tax-free.<sup>203</sup> Finally, IRC § 419A(f)(6) provides another exception to the limitation rules. It exempts a plan that is part of a ten-or-more-employer plan where more than one employer contributes and “no employer normally contributes more than 10 percent of the total contributions . . . under the plan.”<sup>204</sup> Although there are serious limitations imposed on the deductibility of contributions, these exceptions help certain employers revert to the pre-1985 deduction rules.

## IV. VBAs: SHIFTING THE RISK OF RETIREE MEDICAL BENEFITS FROM THE EMPLOYER AND THE UNION TO RETIREES

VBAs are supposed to be a win-win—companies get a clean balance sheet by

195. *Id.* at §§ 419A(a)–419A(c).

196. Ryan, *supra* n. 178, at 1189 (discussing restrictions on VEBA funding). As provided in Code section 162, an employer can deduct the expense for benefits payable in the tax year if they are “ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business.” I.R.C. § 162(a).

197. *See* Moran, *supra* n. 129, at 87 (discussing limitations on VEBA funding).

198. *See id.* (discussing limitations on VEBA funding).

199. I.R.C. § 419A(f)(5)(A).

200. Moran, *supra* n. 129, at 90 (discussing VEBA exemptions from account limits); *see also* Treas. Reg. § 1.419A-2T, Q&A-2.

201. I.R.C. § 419A(f)(5)(B).

202. *See* Moran, *supra* n. 129, at 90 (discussing VEBA exemptions from account limits).

203. *See id.* (discussing VEBA exemptions from account limits).

204. I.R.C. § 419A(f)(6)(B).

offloading and outsourcing liabilities for retiree benefits; retirees get to keep some of their medical benefits. Sounds like a silver lining in what has been the dark cloud of retiree medical benefits. If VEBAs are sufficiently funded and the investments produce enough income to provide ongoing retiree medical benefits at current benefit levels, VEBAs will be successful.<sup>205</sup> It may just be too good to be true.

Probably the most important benefit of a VEBA from the retirees' perspective, beyond the possibility of continued medical benefits, is that it separates the funds for retiree benefits from the employer's general assets to a trust.<sup>206</sup> The traditional pay-as-you-go method puts all of the retirees' eggs in one proverbial basket—if the company failed, the promise of lifetime benefits also failed.<sup>207</sup> With a VEBA, even if the company becomes financially distressed or files for bankruptcy, none of the company's creditors can invade the VEBA trust's assets.<sup>208</sup> The VEBA trustees can then use its assets solely for retiree medical benefits. While that seems good for the retiree, there are some significant issues with the VEBA—in many different ways, it shifts the risk of and responsibility for providing retiree medical benefits from the employer to the retiree.

First, after funding the VEBA, the company's responsibility to retirees ends. The retiree, however, is often still dependent on the company because an increasing number of companies are funding VEBAs with company stock.<sup>209</sup> The extent of the retirees' benefits, therefore, will be a function of the stock price. The retiree is helpless in this regard and depends solely on the company to perform well so that the stock price will increase to provide the VEBA with additional net worth. When the stock price falls, it can be disastrous for the VEBA.

One example of this is the Wheeling-Pittsburgh VEBA, which the company established as part of its chapter 11 bankruptcy reorganization.<sup>210</sup> The company funded the VEBA with about 4 million shares of its stock.<sup>211</sup> Subsequently, the stock price declined by 27% in one week, which translated into a \$13 million dollar loss for the retirees' VEBA.<sup>212</sup> To exacerbate the problem, the VEBA had restrictions on its ability to sell the company stock.<sup>213</sup> Therefore, the extent of each "retiree's medical coverage is ultimately a function of the value of the VEBA, which in turn depends on the value of the Wheeling-Pittsburgh stock."<sup>214</sup>

Second, the initial funding of the VEBA may be inadequate and that risk falls on the retiree as well. When GM announced its VEBA deal with the UAW in 2008, UAW President Ron Gettelfinger claimed that the VEBA "would secure benefits of our retirees

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205. Rothstein, *supra* n. 11, at 63.

206. Keating, *supra* n. 65, at 460.

207. *Id.*

208. *Id.*

209. By the end of 2009, Ford owed \$6.3 billion to the retirees' VEBA. Kaiser Family Foundation, *UAW Agrees to Allow Ford to Make VEBA Payments in Company Stock*, <http://www.medicalnewstoday.com/articles/140204.php> (Feb. 25, 2009). Recently, the UAW and Ford agreed to allow up to 50% of the VEBA payments to be in Ford common stock. *Id.*

210. See Keating, *supra* n. 65, at 455.

211. *Id.* at 455–456.

212. *Id.*

213. *Id.* at 456.

214. *Id.*



and every seniority employee and remain solvent for 80 years.”<sup>215</sup> As discussed earlier, however, healthcare costs have soared since the 1980s. If the cost of healthcare should rise at a rate faster than the UAW has predicted or the returns on the investments to the VEBA are less than predicted, the VEBA’s assets could become insufficient to cover the cost of the retiree benefits and “the burden of healthcare coverage will fall to the UAW and its members.”<sup>216</sup> The worst-case scenario, of course, is that the VEBA would go bankrupt, leaving retirees with nothing.<sup>217</sup> For example, in 1998, Caterpillar and the UAW established a VEBA with \$32.3 million to pay for retiree medical benefits.<sup>218</sup> Six years later, the VEBA collapsed because of rising healthcare costs leaving the retirees with significant unexpected out-of-pocket expenses.<sup>219</sup>

Finally, the risks of providing retiree medical benefits are shifting to retirees because there is a divergence in the interests between the unions<sup>220</sup> and the employees.<sup>221</sup> Retirees have no real power and no vote when it comes to negotiations between the employer and the union. Historically, retirees have depended on unions to represent their interests in disputes with employers.<sup>222</sup> Active union members who have the power of the vote have a sense of loyalty to retirees for the labor expended for the employer through the years.<sup>223</sup> Not only that, perhaps one day, these active union members will be retirees and will have to live with whatever agreement the union has negotiated for them.<sup>224</sup> Recently, however, in several situations, retirees have sued claiming that their union is not properly representing their interests.<sup>225</sup> Professor Keating attributes this divergence of interests to human nature—“when the overall pie gets smaller, as it certainly has in the labor arena as of late, it is naturally harder for current workers to be generous to retirees.”<sup>226</sup> A recent example of this followed Ford’s establishment of a VEBA for retiree medical benefits. Retirees sued claiming that the union should not have been permitted to represent their interests.<sup>227</sup> The court rejected this argument and referred to the VEBA as a “fair approach.”

Shifting the burden and risk of providing retiree medical benefits to retirees is a controversial conundrum because of the enormous uncertainty surrounding the success or failure of the VEBA. Here, I am reminded of the quote that I opened the paper with from the early 1950s. Charles Wilson, President of GM at the time, declared: “What’s

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215. Simone Landon, *The Concession Trap: Auto Worker Givebacks and Labor’s Future*, 29 *Multinational Monitor* 25 (Sept./Oct. 2008).

216. *Id.* (quoting Ron Gettelfinger, UAW President); Rothstein, *supra* n. 11.

217. Rothstein, *supra* n. 11, at 63.

218. Sharon Silke Carty, *UAW Wary of Health Care Changes*, <http://abcnews.go.com/Business/story?id=3554176&page=1> (Sept. 3, 2007).

219. Rothstein, *supra* n. 11 at 63.

220. As stated earlier in the paper, the use of the VEBA to fund retiree medical benefits is being used in large part by unionized industries and that is why it is appropriate to discuss the shift of risk from the union to the retiree here.

221. Keating, *supra* n. 65, at 455–459.

222. *Id.* at 456.

223. *Id.*

224. *Id.*

225. *Id.*

226. Keating, *supra* n. 65, at 455–459.

227. *UAW v. Ford Motor Co.*, 2006 WL 1984363, \*\*28–29 (E.D. Mich. July 13, 2006); *see also UAW v. GM*, 497 F.3d 615, 626 (6th Cir. 2007) (holding that retirees were adequately represented).

good for the country is good for General Motors, and vice versa.”<sup>228</sup> Of course, at that time, he did not have VEBAs in mind, but I wonder if that statement will hold true for the VEBA. Only time will tell. The real question for retirees is what choice do they really have? Without the pre-funding or vesting of benefits, it seems that the choice in many cases is between no benefits at all and having some benefits with a VEBA—an easy choice. Other options are explored below.

First, retirees could purchase private insurance. It, however, often provides less comprehensive coverage than group insurance through an employer.<sup>229</sup> Moreover, it is usually very expensive for an older person or someone with health problems.<sup>230</sup> For example, private insurance for an individual can cost up to \$15,000 compared to employer provided insurance where premiums for retirees average \$7,020.<sup>231</sup>

Second, retirees who lose insurance coverage from an employer’s plan may elect to continue the same coverage under the Consolidated Omnibus Budget Reconciliation Act (COBRA).<sup>232</sup> This coverage, however, is generally only available for 36 months. In addition, the retiree would have to pay the entire premium for coverage, which most retirees cannot afford to do.<sup>233</sup>

Third, the government may provide coverage to a select group of individuals. Medicaid<sup>234</sup> provides coverage for the poor and near poor.<sup>235</sup> There are very strict income guidelines, however, so many retirees do not qualify.<sup>236</sup> The Veterans’ Health Administration may provide coverage if the retiree is a veteran or survivor of a veteran.<sup>237</sup> Finally, if the retiree has reached age 65, Medicare<sup>238</sup> provides coverage. Medicare, however, only covers approximately 51% of healthcare expenses for most individuals.<sup>239</sup>

#### V. BANKRUPTCY PROTECTION FOR RETIREES AS A VEBA ALTERNATIVE?

Instead of employers shifting the risk of retiree medical benefits to retirees by using a VEBA, some retirees urge their former employers to file for chapter 11 bankruptcy. Retirees urge this because they believe that the Bankruptcy Code protects their medical benefits. Congress enacted § 1114 of the Bankruptcy Code in direct response to LTV’s chapter 11 bankruptcy where the company announced that it was

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228. E.D. Hirsch, Jr., Joseph F. Kett & James Trefil, *The New Dictionary of Cultural Literacy* 472 (3d Ed., Houghton Mifflin 2002) (Statement of Charles Wilson, President of GM, 1941-1953).

229. Pratt, *supra* n. 40, at 107-108.

230. *Id.*

231. *Id.*

232. *Id.* at 108.

233. *Id.*

234. For information on Medicaid, see U.S. Dept. for Health and Human Servs., *Medicaid Program—General Information*, <http://www.cms.hhs.gov/MedicaidGenInfo/> (last updated Mar. 3, 2010). Medicaid is a state administered program and each state sets its own guidelines regarding eligibility and services. *Id.*

235. Pratt, *supra* n. 40, at 109.

236. *Id.*

237. Pratt, *supra* n. 40, at 109.

238. Medicare is a health insurance program administered by the United States. Citizens or permanent residents of the United States are eligible for Medicare coverage if they have worked for at least ten years and are age sixty-five or older. See generally Medicare.gov, *Medicare Eligibility Tool*, <http://www.medicare.gov/MedicareEligibility/Home.asp?dest=NAV|Home|GeneralEnrollment#TabTop> (last updated Sept. 17, 2008).

239. Pratt, *supra* n. 40, at 109.

terminating its health benefit plan for 78,000 retirees and their dependents. Congress's general message in enacting § 1114 was that companies in a chapter 11 bankruptcy reorganization should continue to pay as much of the promised health benefits to retirees as possible while still reorganizing the company.<sup>240</sup> Despite the existence of § 1114, companies have continued to terminate or reduce retiree medical benefits in bankruptcy. For example, between 1998 and 2003, 250,000 steelworker retirees lost their medical coverage due to company bankruptcies.<sup>241</sup> If there is protection in bankruptcy, how does this happen?

The truth is, as one commentator notes, § 1114 is "better than nothing at helping retirees protect their benefits, but not a whole lot better."<sup>242</sup> Courts have held that § 1114 "does not create substantive rights to retiree insurance benefits that do not exist under non-bankruptcy law."<sup>243</sup> Moreover, the United States Court of Appeals for the Second Circuit noted that § 1114 "require[s] only that the debtor in reorganization 'continue to provide benefits according to the plan in effect at the time of the declaration of bankruptcy.'"<sup>244</sup> This means that if the company reserved the right to alter or amend the benefits before the bankruptcy, the company has these same rights in bankruptcy.

In 2005, Congress amended the Bankruptcy Code presumably to prevent employers from modifying benefits on the eve of filing for bankruptcy.<sup>245</sup> The new § 1114(l) provides that if the employer modifies retiree medical benefits within 180 days of filing bankruptcy and is insolvent at the time, the bankruptcy court shall reinstate the benefits at the pre-modification levels "unless the court finds that the balance of the equities clearly favors such modification."<sup>246</sup> Again, "this new provision would do nothing to help retirees post-confirmation in a case where the original retiree benefit promise included a right by the employer to terminate the benefits at any time."<sup>247</sup>

The "unless the court finds that the balance of the equities clearly favors such modification" standard is a nebulous standard that allows employers to terminate benefits if it's necessary to permit the employer's reorganization.<sup>248</sup> After all, § 1114 only creates

240. Keating, *supra* n. 65, at 447–448. Section 1114 defines "retiree benefits" as:

payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program (through the purchase of insurance or otherwise) maintained or established in whole or in part by the debtor prior to filing a petition commencing a case under this title.

11 U.S.C. § 1114 (2006).

241. Keating, *supra* n. 65, at 448.

242. *Id.* at 447.

243. Keating, *supra* n. 86, at 41 (citing *In re Doskocil Cos., Inc.*, 130 B.R. 870 (Bankr. D. Kan. 1991)).

244. *Id.* at 42 (quoting *In re Chateaugay Corp.*, 945 F.2d 1205, 1209 (2d Cir. 1991)).

245. Keating, *supra* n. 40, at 991.

246. *Id.* (quoting 11 U.S.C. 1114(l)). Section 1114(l) of the Bankruptcy Code states:

If the debtor, during the 180-day period ending on the date of the filing of the petition—(1) modified retiree benefits; and (2) was insolvent on the date such benefits were modified; the court, on motion of a party in interest, and after notice and a hearing, shall issue an order reinstating as of the date the modification was made, such benefits as in effect immediately before such date unless the court finds that the balance of the equities clearly favors such modification.

11 U.S.C. § 1114(l).

247. Keating, *supra* n. 65, at 447.

248. Keating, *supra* n. 40, at 993.

a claim against the employer for retiree medical benefits—albeit favored treatment.<sup>249</sup> When retiree medical benefits reach the millions or billions of dollars, however, how is a struggling company that is already in bankruptcy supposed to create a plan of reorganization that gets the support of other creditors?<sup>250</sup> If retirees get paid, then other creditors do not. The truth is, there is often nothing left after lien holders have their constitutional rights protected, even for this new favored class of creditors.<sup>251</sup> Retirees, therefore, find little protection in the Bankruptcy Code.

## VI. IT IS TIME FOR CHANGE

For retirees, the guaranteed receipt of medical benefits provided by an employer in retirement is a pipe dream at best. A promise of retiree medical benefits from an employer and § 1114 of the Bankruptcy Code protection offer no security for the retiree. Even a funded VEBA is far from a guarantee of benefits because the retiree is assuming the risk of underfunding and increased healthcare costs after the employer has walked away. To obtain more of a guarantee and to have some security in retirement, pre-funding and vesting are now required for retiree benefits just as they were for pension plans when Congress first enacted ERISA. Therefore, it is time for Congress to act and pass legislation to protect retirees.

### A. *The Need for an ERISA Amendment*

I revisit the underlying reasons for the passage of ERISA here because the underlying issues that warranted its passage in 1974 are again prevalent today. In 1987, Professor Gregory described the formation of ERISA: “Throughout the 1960’s, pension plan abuses increased dramatically. Existing regulations proved dysfunctional and unable to protect pension rights. Case law and common law were not effective remedial or enforcement instruments. Congress was faced with the compelling need to provide an effective national solution for this pressing national problem.”<sup>252</sup> Today, the need is no less compelling.

Professor Gregory went on to describe why there was a need for change. “Business terminations, employers’ temporary reductions in force, layoffs, and bankruptcies . . . wreaked havoc with pension rights. To compound this bleak situation, many pensions were inadequately funded and not invested in diversified markets. In the early 1970’s, the stock market plummeted. Correspondingly, pension funds were seriously debilitated.”<sup>253</sup> The Senate described the need for ERISA as follows: “[ERISA’s] most important purpose will be to assure American workers that they may look forward with anticipation to a retirement with financial security and dignity, and without fear that this period of life will be lacking in the necessities to sustain them as human beings within

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249. *Id.*

250. Keating, *supra* n. 65, at 447–448. The court in a recent bankruptcy case stated, “short of printing money, there is no way to see that all claims are paid in full.” *In re GF Corp.*, 115 B.R. 579, 585 (Bankr. N.D. Ohio 1990).

251. Keating, *supra* n. 86, at 19.

252. Gregory, *supra* n. 69, at 443 (citations omitted).

253. *Id.*

our society.”<sup>254</sup>

In general, ERISA responded to two public concerns: unfunded pensions and unvested pensions.<sup>255</sup> ERISA, however, regulates both pension plans and welfare plans. It regulates welfare plans through its reporting and disclosure requirements, fiduciary rules, and enforcement provisions.<sup>256</sup> At the time of its passage, however, pension plans were much more prevalent and important than welfare plans and, consequently, Congress directed most of ERISA’s substantive regulation—pre-funding and vesting—to pension plans.<sup>257</sup>

Welfare plans have grown in significance since Congress enacted ERISA and its lack of pre-funding and vesting requirements for welfare plans have wreaked havoc for retirees. As a result, Congress has begun to expand ERISA’s substantive regulations of welfare plans. The expansion began in 1985 when Congress enacted COBRA, which requires group health plans to make coverage available to employees who may otherwise lose it due to changes in employment.<sup>258</sup> Congress further extended ERISA’s substantive regulation in 1996 when it passed the Health Insurance Portability and Accountability Act (HIPPA).<sup>259</sup> HIPPA limits the ability of health insurance plans to impose pre-existing coverage exclusions.<sup>260</sup>

While Congress has made great strides in extending ERISA’s substantive regulations to welfare plans through COBRA and HIPPA, the retiree crisis requires that Congress do even more. In this regard, one should not ignore the historical context in which Congress enacted ERISA. “[T]he impetus for Congress was not cases of unfunded retiree medical benefits, but rather a few prominent instances of unfunded pensions that left lifelong employees of certain companies with none of their promised retirement income.”<sup>261</sup> Today, however, the impetus to amend ERISA is unfunded retiree medical benefits. Employees can no longer look forward to the financially secure retirement that Congress envisioned when it first enacted ERISA. Instead, many retirees work for employers for most of their adult lives with the expectation that they would have a secure retirement with the retiree benefits that they were promised when they began working only to find that the benefits have vanished. Congress enacted ERISA to require pre-funding and vesting of pension plans because employers were stripping employees of a secure retirement. Employers are doing the same today with retiree medical benefits.

254. S. Rep. 93-127, 4849 (1973).

255. Mark J. Roe, *The Modern Corporation and Private Pensions*, 41 U.C.L.A. L. Rev. 75, 82 (1993).

256. See ERISA, §§ 3(7), 3(8); 3(16), 3(21), 101-111, 402, 403, 502.

257. Frolik & Moore, *supra* n. 17, at 81.

258. *Id.*; see ERISA, §§ 601-609. In general, COBRA states that “[t]he plan sponsor of each group health plan shall provide . . . that each qualified beneficiary who would lose coverage under the plan as a result of a qualifying event is entitled, under the plan, to elect, within the election period, continuation coverage under the plan.” ERISA, § 601(a).

259. *Id.*; see *id.* at §§ 701-702. The Health Insurance Portability and Accountability Act (HIPPA) states that a group health plan . . . may, with respect to a participant or beneficiary, impose a preexisting condition exclusion only if—(1) such exclusion relates to a condition (whether physical or mental), . . . for which medical advice, diagnosis, care, or treatment was recommended or received within the 6-month period ending on the enrollment date; (2) such exclusion extends for a period of not more than 12 months . . . after the enrollment date . . . *Id.* at § 701(a).

260. *Id.*

261. Keating, *supra* n. 86, at 21.

Therefore, Congress should impose the same regulations for these plans.

*B. The Rationale for not Requiring Pre-funding and Vesting is Outdated*

There are a number of theories as to why Congress originally chose not to apply the same vesting and pre-funding requirements in ERISA for welfare plans as it did for pension plans.<sup>262</sup> First, Congress was fearful of overburdening employers with too many pre-funding and vesting requirements and that these requirements would discourage employers from maintaining these plans at all.<sup>263</sup> Given the ease with which employers can terminate medical benefits if they have reserved such a right, this theory may still hold true today. Pre-funding and vesting, however, are near certainties—retirees know exactly what they are getting. If an employer chooses not to offer retiree medical benefits because Congress requires pre-funding and vesting, again, retirees know exactly what they are getting. Presently, retirees go through their working life expecting to have medical benefits in retirement, and then its stripped away from them unexpectedly. The certainty of pre-funding and vesting allow retirees to know what to expect in retirement and allow employees to plan for it for their entire life.

Second, Congress distinguished welfare plans from pension plans because of the great unpredictability of pre-funding for reimbursement of future medical expenses.<sup>264</sup> While pre-funding may be difficult and may require actuarial predictions, this theory, in the present day, is unacceptable. This is exactly what employers are doing when they shift responsibility from themselves to retirees using a VEBA, which is nothing more than a trust that is actuarially predicted to pay future medical expenses. If we accept this theory today for why ERISA cannot require pre-funding of medical benefits, then we cannot accept the VEBA.

*C. Social Justice*

Another reason it's time for an ERISA amendment is for social justice. We, as a society, feel compelled to protect certain industries in this country, especially those that have been around as long and employ as many people as GM. Although there is blame to go around for why the American economy is in the state that it's currently in, we can appreciate the difficult positions that our iconic American companies face. Ford, for example, lost \$17 billion in 2007 and \$14.6 billion in 2008 after cutting production by 25% in the third quarter and by as much as 14% in the fourth quarter.<sup>265</sup> Its market capitalization—a measure of a company's value in the market place—declined from \$60 billion in 1999 to \$12 billion currently.<sup>266</sup> Its investment grade rating in 2000 was "A+, well within what is regarded as investment grade."<sup>267</sup> By March 2005, Ford's investment grade was downgraded to "junk."<sup>268</sup> Twelve years ago, Ford's market share of the

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262. *Id.*

263. *Id.*; see also Stabile, *supra* n. 99, at 1952–1953.

264. Keating, *supra* n. 86, at 21.

265. *UAW v. Ford Motor Co.*, 2008 WL 4104329, \*\*3–4 (E.D. Mich. Aug. 29, 2008) (citing declaration of Peter J. Daniel); Ford, *supra* n. 7.

266. Ford, 2008 WL 4104329 at \*4 (citing declaration of Peter J. Daniel).

267. *Id.* (citation omitted).

268. *Id.*

automobile industry was 25%, but has eroded to 14.6%.<sup>269</sup>

Ford's retiree benefits have been a major factor in the company's financial condition. Its retiree benefits currently absorb 16% of its annual revenue.<sup>270</sup> This, in turn, diverts significant amounts of resources from business operations and erodes investor confidence, which leads to financial trouble.<sup>271</sup> Ford's foreign competitors, however, lack this legacy cost, which fuels its competitive disadvantage.<sup>272</sup> Therefore, according to Ford, because of the retiree medical benefit costs, the company is in financial crisis.

The retiree, however, seems to be all but forgotten in this dichotomy between employer and retiree. When the employer cuts or eliminates benefits, the retiree usually does not have alternatives to rely on.<sup>273</sup> Because of costs and considerations of uninsurability, the employer is often the retiree's only source of insurance, especially for those retirees that are not yet eligible for Medicare.<sup>274</sup> Furthermore, retirees, unlike companies, cannot pass their loss on to customers; nor can retirees "absorb the loss through a balance sheet adjustment."<sup>275</sup> We, as Americans, should be compelled to protect retirees as well.

There is a great social utility in taking care of retirees, whether they are family, elderly, or sick.<sup>276</sup> Providing for retirees is deemed socially useful when it "increases the sum total of welfare in society."<sup>277</sup> Stripping retirees of their medical benefits in their most vulnerable state—that is, when they are in retirement and dependent on the promise of benefits from an employer—is a disutility to society as a whole because it forces many retirees into poverty.<sup>278</sup> "Quite simply, poverty imposes a high cost on society at large."<sup>279</sup> The very risk that an individual might become impoverished in the future is an economic risk to those individuals that, at present, are not impoverished.<sup>280</sup>

Lifting people out of poverty is costly to society as well.<sup>281</sup> The most efficient

269. *Id.*

270. *Id.* at 5 (citing declaration of Barbara Benson).

271. *Ford*, 2008 WL 4104329 at \*5.

272. *Id.* For example, in 2007, Ford's total per-hour labor cost was \$25 to \$30 greater than that of Toyota, Honda, and Nissan. *Id.*

273. *Stabile*, *supra* n. 99, at 1947.

274. *Id.*

275. *Id.*

276. *See Koresko & Martin*, *supra* n. 122, at 1.

277. *See id.* (quoting Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. Chi. L. Rev. 63, 65 (1990)).

278. "The definition of poverty is elusive, its identification simpler." Richard A. Posner, *Economic Analysis of Law* 476 (6th ed., Aspen Publishers 2003). For 2009, the United States defines poverty as any one person that has an income of \$10,830 or less. *See Dept. of Health and Human Servs., The 2009 HHS Poverty Guidelines*, <http://aspe.hhs.gov/POVERTY/09poverty.shtml> (last updated Mar. 4, 2010). When a retiree pays the exorbitant premiums for private insurance or is forced to pay out of pocket for medical care, their income could easily fall below this level.

279. *Koresko & Martin*, *supra* n. 122, at 2 (citing Lee Ann Fennell, *Interdependence and Choice in Distributive Justice: The Welfare Conundrum*, 1994 Wis. L. Rev. 235, 240 (1994) ("The welfare dilemma grows out of the fact that poverty is extremely costly to all of society, including the nonpoor. Because of the costs that poverty imposes on all of society, the nonpoor would be willing to pay to have it alleviated.")).

280. *Id.* at 2; *see also Posner*, *supra* n. 278, at 478 ("An affluent person who is risk averse will want to insure against the possibility of becoming poor in the future because of business reverses, poor health, changes in the labor market, or other misfortunes.").

281. *Koresko & Martin*, *supra* n. 122, at 4.

solution, therefore, is “to allow individuals to aid in self-help such that individuals can lift themselves from poverty or avoid it altogether.”<sup>282</sup> This self-help has generally come from obtaining employee welfare benefits such as medical and dental insurance from the employer.<sup>283</sup> Americans engage in this “self-insurance against poverty” because they appreciate the risk that, without such benefits, they could end up in poverty.<sup>284</sup> As already discussed, due to the increased costs of providing retiree benefits and economic downturn, retirees “can no longer count on the provision of these once-relied-upon benefits and protections against poverty, even if [retirees are] able to share in the cost of the benefits.”<sup>285</sup> As a result, many retirees have insufficient amounts of insurance to adequately guard against the risk that they and their families will fall into poverty.<sup>286</sup>

Future retirees need more than the possibility that they can self-insure against poverty. They need certainty. Amending ERISA to require pre-funding and vesting of retiree medical benefits so that the retirees’ expectations are certain—whether the employer or employee is providing retiree medical benefits in retirement—is the first step in facilitating this certainty. Until we get an amendment, retirees, at least the fortunate ones, have the possibility of insurance against poverty through a VEBA.

## VII. CONCLUSION

As the cost of providing welfare benefits rise and the ever-increasing need to be more competitive escalates, employers are shifting the risk of providing retiree medical benefits to retirees themselves through a VEBA. Retirees are saddled with the risk that health care costs will escalate beyond current expectations, that their past employer underfunded the VEBA, that VEBA investment returns will sour, and ultimately that the VEBA will go bankrupt leaving them with no medical benefits. The passage of time will tell whether VEBAs are successes or failures. In the mean time, retirees really have no other choice than to accept the terms of the VEBA. The alternative—no medical benefits at all—is really no choice at all.

Employers, of course, are generally free to make empty promises to retirees of future benefits for life as long as they have reserved the right to change the benefits at any time. When Congress enacted ERISA to regulate benefits, it chose not to impose the same requirement for pre-funding and vesting of welfare benefits as it did for pension benefits. The issue, however, that retirees face today—the promise of a secure retirement stripped away when retirement actually presents itself—is the same issue that retirees faced when Congress first enacted ERISA. The time, therefore, has come for Congress to amend ERISA to provide certainty in retirement for welfare benefits.

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282. *Id.*

283. *See id.*

284. *Id.* at 5.

285. *Id.*

286. Koresko & Martin, *supra* n. 122, at 5.



