

Shifting Responsibility for Providing Retiree Health Benefits from Employers to Voluntary
Employee Beneficiary Associations

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This past fall's labor negotiations in Detroit between the United Auto Workers (UAW) and the three large American automakers—Chrysler, General Motors (GM), and Ford—drew the media's attention to the concept of Voluntary Employee Benefit Associations (VEBAs). Transferring the responsibility for providing retiree health benefits, liabilities of up to \$112 billion dollars,¹ from the automakers to a union-sponsored VEBA trust was a central issue in bargaining. Ultimately, all three automakers agreed to contribute cash and securities valued at over \$54 billion to the VEBA trust or trusts that will provide retiree health benefits to the manufacturers' 540,000-plus retirees and surviving spouses and 180,000 current employees who will be eligible for such benefits upon retirement.² Both labor and management promise that releasing automakers from their obligations to provide retiree health benefits and shifting that responsibility to VEBAs will be mutually beneficial—securing financial security for the automakers and healthcare security for the retirees.³

The automaker-UAW deals propose to fundamentally change the retiree health benefit arrangement by eliminating the employer's obligation to provide retiree benefits once the financing of the VEBA is complete. If the VEBA exhausts its funds at a faster rate than anticipated, retirees will face the reduction or termination of their benefits, without recourse against the employer. These proposals are the most radical type of arrangements that use VEBAs to finance retiree health benefits. Understandably, some retirees and labor activists are concerned about relieving employers of these obligations in exchange for a lump sum of assets. During the fall automaker negotiations, *The New York Times* reprinted an open letter from three former UAW officers asserting that retiree benefits provided by the automakers were a hard-won benefit and “the potential consequences of adopting such a plan will be economically painful, if not disastrous, to those covered by it.”⁴ Union activist magazine *Labor Notes* quoted one UAW

member as complaining that “whatever the company stands to save, retirees stand to lose. Eventually, [the arrangement] will put the union in charge of demanding retirees pay more out of pocket to make up for the shortfall.”⁵

Agreements that absolve an employer of its responsibility for providing retiree health benefits in exchange for a contribution to union-sponsored retiree health VEBAs are relatively rare, but not unprecedented. Truck-manufacturer Navistar negotiated a reduction in its retiree health benefit obligations with UAW in exchange for a contribution to a VEBA in 1992 and at the end of 2006 the United Steel Workers and Goodyear negotiated a pending arrangement that relieves the tire-maker of any obligation to provide retiree health benefits after it funds a retiree health benefit VEBA.⁶ The UAW-automaker deals, because of their size, have garnered unprecedented attention in corporate boardrooms and among union leadership. As the parties signed the most recent round of contracts this past fall, other large employers, including telecommunications firms like AT&T, Verizon, and Qwest, announced that they too might be interested in such an arrangement.⁷ Other unions, such as those that represent employees at Lockheed and Boeing, also voiced interest in taking over retiree health benefits.⁸ The attention comes as no surprise because, as of June 2006, companies listed in the S&P 500 index have only funded 22% of their retiree health benefit liabilities, a shortfall of \$321 billion dollars.⁹

This paper attempts to assess the groundbreaking and potentially trend-setting UAW-automaker agreements as well as other less radical arrangements that use VEBAs to finance retiree health benefits by examining the mechanisms involved and identifying the possible risks and benefits of such arrangements. The first section reviews the VEBA as an entity and the regulatory schemes that govern it. The second section examines the different mechanisms through which an employer’s retiree health benefit responsibilities may be shifted to VEBAs—

many of the VEBAs compared with the pending UAW-automakers deal in the media are the products of different arrangements, which either altered a legal right in bankruptcy, a situation in which all unsecured creditors would be expected to compromise their claims, or were negotiated before the retiree benefits at issue were vested. The third section considers the interests that employers, unions, and retirees have in shifting the responsibility for providing retiree health benefits from employers to VEBAs and the risks that each group takes on in the arrangements. Ultimately, the paper concludes that many uses of VEBAs in retiree health benefit financing are benign, but the deals that alter a putative existing legal obligation of employer—like the pending UAW-automaker deals—are more problematic. In these circumstances, courts, which have an opportunity to review such arrangements, should vigilantly guard the interests of retirees.

I. What is a VEBA?

Though “VEBA” was a new buzzword in the news coverage of the automaker contract negotiations, the concept dates back to 1928 and,¹⁰ in itself, is not the most revolutionary aspect of the deals. A VEBA is an essential component of these arrangements because it serves as an independent entity that can accumulate earnings on its investments largely tax-free and receive tax-deductible contributions from the sponsoring employer.¹¹ The VEBA is a creature of the Internal Revenue Code (“Code” or IRC), a particular type of tax-exempt organization that is treated for tax purposes like a qualified charity or religious institution. There are almost 9,200 of these organizations,¹² providing retiree healthcare coverage and other related non-pension benefits, such as life, vacation, and even child-care benefits, to retirees, surviving spouses, and current employees.¹³ Importantly, the Code is not the only statutory scheme that regulates the funding and administration of these entities when they are used to provide retiree health benefits.

Both the Employee Retirement Income Security Act (ERISA) and securities laws may also apply.

Requirements for Tax Exempt Status

VEBAs derive their tax-exempt status from sections 501(a) and 501(c)(9) of the Code, which provides an exemption for a “[v]oluntary retiree benefit association 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.”¹⁴

The Treasury Regulations interpret that section to mean that there are four requirements an entity must meet to qualify as a tax-exempt VEBA: (a) it must be “an employees’ association,” (b) membership must be voluntary, (c) its primary purpose must be to provide “life, sick, accident” and selected other benefits to members, their dependents, and designated beneficiaries, and (d) none of the organization’s net earnings, other than those specified benefits, can inure “to the benefit of any private shareholder or individual.”¹⁵

Further guidance from the regulations illustrates that a properly established and managed retiree health benefit VEBA can meet all four requirements to maintain tax exempt status. To qualify as an “employees association,” the membership “must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond.”¹⁶ The regulation extends the term “employee” to reach retirees as well as their surviving spouses and dependents.¹⁷ An “employment related common bond” can include employment in a common employer or membership in a labor union.¹⁸ Membership can be further restricted, but not in a way that favors officers, shareholders, or highly compensated employees.¹⁹ To

qualify as an “association,” there must be a separate entity “having an existence independent of the member-employees or their employer.”²⁰ Retiree health benefit VEBAs generally satisfy this provision because they are established as independent trusts, which can be managed by appointees of their membership, independent trustees, designees of an employer,²¹ jointly by an employer and a union, or by a union alone.²² The trust form also satisfies a requirement of ERISA that “all assets of an employee benefit plan be held in trust by one or more trustees.”²³

Retiree health benefit VEBAs easily satisfy the second and third regulatory requirements. The regulations take a broad view of voluntary membership. The requirement is satisfied provided that an employee “does not incur a detriment (for example, in the form of deductions from pay) as the result of membership in the association,” or if membership is required as a condition of a collective bargaining agreement or union membership.²⁴ The definition of “sick and accident benefits” in the regulations contemplates typical retiree health benefit offerings, including payments and reimbursements for the illness and injury expenses of members and their dependents, as well as preventive care. These benefits may be provided directly by payments to members or providers or indirectly through premium payments to insurers.²⁵

The fourth requirement outlined by the regulations, which prohibits the inurement of the entity’s earnings to any individual aside from the payment of legitimate benefits,²⁶ serves to protect the organization’s assets from abuses by administrators. The regulations provide specific examples of prohibited inurement including excessive trustee or VEBA employee compensation and payments to service providers associated with trustees or administrators that exceed the fair market value of the services provided.²⁷ Further, the regulations prohibit the payment of “disproportionate benefits,” specifically payments of excessive benefits to highly compensated employees of a sponsoring employer.²⁸ A uniform retiree benefit package for all participants, or

a uniform package with enhanced benefits for retirees with smaller pension incomes, as the recent VEBA deals appear to offer, should satisfy this provision.

The prohibited inurement rules also regulate the distribution of assets in the event of the termination of the VEBA. It is difficult to imagine a situation in which a retiree health benefit VEBA would be terminated with considerable assets left to distribute, though the implementation of state-provided universal healthcare or a significant expansion of Medicare that drastically reduced the beneficiaries' copayment and coinsurance responsibilities could leave the plans with such a windfall. One permitted option in the event a VEBA is left with excess assets is to provide its members expanded or additional permitted benefits, which could include life insurance.²⁹ The other option, which is only permitted in the event of a complete dissolution, is to distribute the excess assets to members, either in accordance with the terms of a collective bargaining agreement or based on "objective and reasonable standards" that do not disproportionately favor highly compensated employees, officers, or shareholders of the sponsoring employer.³⁰ Importantly, the remaining assets in a terminating VEBA can never be returned to the contributing employer.³¹

Restrictions on the Deductibility of Contributions

In addition to providing a financing vehicle exempt from taxation on its investment income, contributions to a VEBA pursuant to a collective bargaining agreement, or to cover the present value of retiree health benefit costs for current retirees, are deductible even if the contributions are made in a lump sum; thus, an employer can realize an immediate tax benefit for obligations that have not yet come due. Before the Second World War, when employer-provided health benefits were rare, VEBAs were largely employee-funded mutual assistance societies.³² In fact, until 1942 the code required that at least 85% of contributions come from the employees

themselves.³³ When Congress lifted the cap on employer contributions, VEBAs became a tool for employer tax avoidance.³⁴ An employer is generally only able to deduct employee welfare benefit expenses paid directly to an employee (or retiree), benefit administrator, or insurance company in the year the payment is made or the expense is incurred.³⁵ However, prior to 1986, employers were able to establish health benefit trusts—typically VEBAs—and take a deduction for their contributions, “irrespective of when the actual benefit was paid out to the employees.”³⁶ Using a trust therefore allowed employers to time deductions to years in which the contributions would be most useful in offsetting tax liability. Contributions in excess of the health benefit expenditures for the year could remain in the trust and grow tax-free.³⁷

With the Deficit Reduction Act of 1984,³⁸ Congress enacted limits to curb the ability of employers to make contributions and take deductions without regard for actual present year health benefit costs or accrued liability. These limits generally prohibit employers from taking deductions for contributions to funded welfare benefit funds, like retiree health VEBA trusts, that exceed the benefits actually paid by that fund in that year.³⁹ The Act, however, also provided two exceptions that can be used to exempt lump sum contributions to a VEBA in situations similar to the recent automaker deals.

The first exception, section 419A(c)(2) of the Code, permits employers to take deductions for contributions to a reserve in the trust used to fund post-retirement health and life benefits, provided that reserve is “funded over the working lives of the covered employees and actuarially determined on a level basis.”⁴⁰ Until 2003, there was some question as to whether an employer could take an immediate deduction for a contribution equaling the total present value of the accrued retiree health liability of its current retirees. The Internal Revenue Service (Service) informally took the position that employers could not take such a deduction, but must spread the

contributions over time.⁴¹ The Tax Court, however, ruled in *Wells Fargo & Company v. Commissioner* that an employer could take a full deduction for a lump sum contribution satisfying the present value of accrued current retiree health benefit liabilities calculated using the “individual premium cost method.”⁴² The individual premium cost method is an actuarial approach that determines liability by calculating the cost for “each covered employee as a level dollar amount which, if accumulated from the later of the date the plan is established or the date that the employee was hired, would accumulate at retirement the amount necessary to fully fund the benefit to the covered employee.”⁴³ The Tax Court held that because current retirees have no more working years over which the reserve can be funded, “the entire present value of the projected benefit is properly allocated to the first year.”⁴⁴ Employers remain unable to deduct lump sum contributions to cover the retiree health benefit costs of a future retiree—the deductibility of contributions intended to finance future retiree costs is limited to an actuarially reasonable present year’s share of those costs as allocated over the years remaining until the employee’s retirement.⁴⁵

The *Wells Fargo* interpretation of section 419A(c)(2) aside, another exception directly permits the deduction of contributions for both active employees and retirees to collectively bargained welfare benefit funds intended to provide retiree health benefits.⁴⁶ Code section 419A(f)(5)(A) specifically exempts contributions made to a welfare benefit trust pursuant to a collective bargaining agreement from limits on deductions altogether. Congress ordered Treasury to craft regulations for this provision with the presumption that “reserves in such plans are not excessive because of the arm’s length negotiations between adversary parties inherent in the collective bargaining process.”⁴⁷ The resulting regulations specify that contributions must not only be made as a result of a labor agreement with a union, but 90% of the membership of the

welfare benefit fund to which the contribution will be made must be employees covered by the agreement.⁴⁸ If an employer did seek a deduction under section 419A(f)(5)(A) for a contribution to a VEBA or other welfare benefit trust whose membership did consist of some, but fewer than 10% active, non-union employees, it cannot include the portion of the contribution attributable to the non-union employees, though a share of that contribution may be deductible under section 419(c)(2).⁴⁹

Impact of Other Regulatory Schemes

In addition to the Code, at least two other regulatory schemes—securities laws and ERISA—govern the funding and maintenance of retiree health benefit VEBAs, particularly when the trust is funded with a significant contribution of employer securities. Securities rules may limit the ability of a VEBA to sell employer stock when it is under the direct or indirect control of the company and deemed an affiliate.⁵⁰ If such restrictions apply, the VEBA may be prohibited from selling any shares for a year and, after that period, may be permitted to only sell a small volume of shares every quarter.⁵¹

VEBAs providing retiree health benefits, like the proposed UAW-automaker VEBAs, will also be subject to ERISA. The Treasury Regulations regarding VEBAs specifically note that the ERISA definition of an “employees’ beneficiary association” that constitutes an “employee organization” that provides a “welfare plan” subject to ERISA is not necessarily coextensive with the Code’s definition of a “voluntary employee benefit association,”⁵² but ERISA’s broad definitions undoubtedly capture VEBAs providing retiree health benefits. ERISA defines an “employee welfare benefit plan” as “any plan, fund, or program,” established or maintained by an employer or “employee organization” to provide its “participants or beneficiaries” health benefits or any non-pension Taft-Hartley plan.⁵³ “Employee organization”

includes “any employees’ beneficiary association organized for the purpose in whole or in part, of establishing [a benefit plan].”⁵⁴

Employee welfare benefit plans qualify as employee benefit plans that are subject to the reporting, fiduciary duty, and enforcement provisions of ERISA.⁵⁵ Many of ERISA’s fiduciary duty requirements may duplicate those provided for by the Code,⁵⁶ but while the Code leaves enforcement in the hands of the IRS, ERISA allows beneficiaries to pursue limited remedies for violations of the statute on their own.⁵⁷ Importantly, employee welfare benefit plans are not subject to ERISA’s participation and vesting rules or minimum funding requirements.⁵⁸ Though trustees and administrators owe a fiduciary duty to beneficiaries in managing the VEBA and distributing benefits, no provision in ERISA or the Code requires VEBAs to be adequately funded to indefinitely provide the benefits that the plan presently offers, or prevents a VEBA’s trustees or managers from reducing or terminating benefits in the future.

ERISA’s fiduciary responsibility provisions take on particular importance when an employer makes significant contributions of its own securities to the plan. News coverage of the UAW-automaker retiree health VEBA deals indicates that all three manufacturers intend to make large contributions of employer securities to fund the trusts that will hold assets worth over \$50 billion.⁵⁹ GM will provide a \$4.3725 billion debenture convertible to stock as part of its proposed \$24.1 billion initial contribution and Ford will provide a similar convertible debenture valued at \$3.3 billion as part of its \$15.4 billion proposed contribution; towards its obligation of \$8.8 billion, Chrysler will contribute an equity warrant worth as much as \$605 million.⁶⁰ A retiree health VEBA deal struck between Goodyear and the steelworkers union at the end of 2006 also potentially involves significant amounts of employer securities, up to \$300 million of the employer’s \$1 billion dollar initial contribution could come in the form of common stock.⁶¹

ERISA generally prohibits transactions between plans, such as these proposed retiree health benefit VEBAs, and parties in interest to the plan, such as the contributing employer.⁶² The statute, however, specifically permits plans to receive and hold qualifying employer securities,⁶³ including stock and marketable obligations, provided that the value of the employer securities held by the plan does not exceed 10% of the total plan assets.⁶⁴ Should the automakers' or Goodyear's contributions of employer securities exceed 10% of plan assets or not qualify as the type of employer securities that plans are permitted to hold,⁶⁵ the parties will need to seek an administrative exemption from the Department of Labor's Employee Benefits Security Administration (EBSA).⁶⁶ To qualify for the administrative exemption from these requirements, EBSA must find that the transactions are administratively feasible and protect the plan and its participants and beneficiaries.⁶⁷

In the past, EBSA has granted these exemptions for transfers of significant amounts of employer securities to VEBAs, provided the VEBA beneficiaries' interests are adequately represented, at least in part, by fiduciaries that are independent from the employer and union that negotiated the deal. For example, in a situation similar to the pending UAW-automaker VEBA deals, EBSA permitted a newly-created Navistar retiree health benefit VEBA to hold a significant amount of employer stock, which could not be sold for a period of five years in accordance with a lock-up agreement.⁶⁸ As in the UAW-automaker proposal, the VEBA at issue had been created as a result of a collective bargaining agreement and a related class action settlement that permitted the employer to relinquish a portion of its putative obligation to provide retiree health benefits in exchange for financing a VEBA.⁶⁹ EBSA's approval exempted the plan's acquisition and holding of the stock from ERISA's prohibited transactions rules, the 10% limit on the plan's holding of qualified employer securities, and the prohibitions on self-

dealing.⁷⁰ The exemption was conditioned on the establishment of a “Supplemental Program Committee,” made up of a majority of members not affiliated with the employer or the union, that would manage the VEBA.⁷¹ EBSA also granted the union’s request that an independent member of this committee be permitted to serve on the employer’s board of directors to advocate for the VEBA during the period in which the shares could not be sold.⁷² More recently, EBSA exempted from the prohibited transaction and maximum holding of employer securities rules the transfer of a significant number of shares of employer stock to two retiree health VEBAs made pursuant to a bankruptcy settlement.⁷³ Notably, the exemption was conditioned on the selection of independent fiduciaries that “have sole discretionary responsibility relating to the acquisition, holding, disposition, ongoing management, and voting of the [s]tock,” and “have negotiated and approved or will negotiate and approve on behalf of their respective VEBAs any transactions between the VEBA and [the employer] involving the [s]hares. . . .”⁷⁴ These conditions demonstrate that EBSA demands that VEBA trustees operate in the interest of the beneficiaries in exercising their rights regarding the securities, rather than acting as an arm of the employer or union. Additionally, despite the exemption to the specific prohibited transaction, percentage limitation, and self-dealing rules, ERISA’s general fiduciary principals continue to apply to the VEBA trustees.

II. Transferring Retiree Health Benefits Obligations to a VEBA

Though all VEBAs will be subject to the provisions of Code section 501(c)(9), likely governed by ERISA, and possibly impacted by securities laws regarding their holding of employer securities, the establishment and funding of the entity does not necessarily alter an employer’s obligation to provide retiree health benefits. One recent survey found that a quarter of employers that provided retiree health benefits, and 40% of employers with more than 20,000

employees providing retiree health, pre-funded some of their anticipated retiree costs, most commonly using VEBAs as the prefunding vehicle.⁷⁵ Not all of these employers have shifted their obligation to provide retiree health benefits to VEBA trusts. In fact since neither ERISA nor the Code requires employers to provide retiree health benefits, some of these employers have no obligation to provide retiree health benefits at all.

Even for employers with some obligation to provide retiree health benefits, using a VEBA as a financing vehicle does alter change the employer's obligations. Most simply, an employer may establish a VEBA to provide retiree health care for tax purposes or at the behest of a union, but may itself remain obligated to provide those benefits unless it discharges that obligation through bankruptcy or a class action settlement with its retirees. If the VEBA's funds are exhausted, the employer's duty to provide continuing retiree health coverage remains the same as it was before it established the trust. Three more complicated VEBA arrangements are discussed below. First, a VEBA may be established as a result of bankruptcy settlement. Second, an employer with no binding obligation to provide retiree health benefits might choose to establish a VEBA with fixed funding to provide its employees or retirees with retiree health benefits, rather than indefinitely providing benefits directly. Third, with court approval of a class action settlement with retirees, an employer may shift an already vested (or at least arguably vested) obligation to provide retiree health benefits to a VEBA. Recent news coverage of the proposed UAW-automaker has often conflated these three different uses of VEBAs.⁷⁶

Vesting

A critical factor in determining exactly what, if any, obligations are shifted from an employer to a VEBA is determining whether retirees have a vested, irrevocable right to continuing health benefits in the first place. Since ERISA and the Code do not mandate the

vesting of retiree health benefits, these obligations are most often derived from collective bargaining agreements and promises made by the employer in plan documents and in other contexts.⁷⁷ Sometimes it is relatively simple to determine whether retirees or active employees have a vested right to these benefits. Courts in almost all circuits would probably determine that benefits provided under a non-collectively bargained plan were not vested if the plan documents clearly stated that coverage 1) was not indefinite and 2) could be revoked at any time. Conversely, most courts would likely find that benefits provided under a non-collectively bargained plan that explicitly guaranteed vested benefits for life and failed to reserve the employer's right to modify the plan were in fact vested.⁷⁸ Likewise, almost all courts would probably find retiree health benefits provided under a collective bargaining agreement that stipulated that the benefits were only guaranteed for the life of the agreement to be unvested.⁷⁹ The courts of appeal, however, are currently split on the precise standards to use in determining whether retirees have a vested right to lifetime health benefits in closer cases.⁸⁰

For example, in *UAW v. Yard-Man Incorporated*,⁸¹ the Sixth Circuit, in which the majority of the VEBA-related litigation discussed below is heard, found a collective bargaining agreement provision that read, “[t]he Company will provide insurance benefits equal to the active group benefits . . . for the former employee and his spouse,” to be ambiguous regarding whether the retiree benefits were vested for life or merely for the term of the agreement.⁸² The court considered, among other factors including related provisions in the agreement and the discretionary nature of bargaining over retiree benefits, that retiree health benefits were “status benefits” that seemingly apply when and for long as the employee attained the status “retired.”⁸³ Commentators have termed the inference that collectively-bargained health benefits granted to all retirees are assumed to be vested for life the “*Yard-Man Inference*.”⁸⁴

Several other circuits have explicitly rejected the *Yard-Man* approach.⁸⁵ For instance, the Seventh Circuit, in *Rossetto v. Pabst Brewing Company*,⁸⁶ argued that it would make more sense for the presumption to be reversed, because a union should be expected to negotiate for express language in the agreement unambiguously vesting the retiree benefits.⁸⁷ The Sixth Circuit itself has noted conflicts and unpredictability in its analysis, finding that reasonable parties can argue that “two lines of Sixth Circuit cases offer competing answers.”⁸⁸ For example, the outcome is unclear when the collective bargaining agreement seems to indicate that the benefits will vest upon retirement, but the plan documents clearly reserve the right to modify or terminate the benefits.⁸⁹ These varying approaches among and sometimes within the circuits and the intricacies of interpreting collective bargaining agreement and welfare benefit plan language, as well as extrinsic evidence when those documents are ambiguous, often make determining whether retiree health benefits are vested a very difficult question.

VEBAs Resulting from Bankruptcy

In a bankruptcy liquidation or reorganization, retirees’ claims to health benefits from an insolvent employer may ultimately be satisfied by a contribution to a VEBA that provides limited benefits. In the event of a liquidation, even retirees with vested rights to employer health coverage will be treated as ordinary unsecured creditors, whose claims must be satisfied out of the estate of defunct company.⁹⁰ In such a situation, retirees will likely receive only a fraction of the value of the originally promised benefits.⁹¹

In bankruptcy reorganization, however, Congress has imposed certain restrictions on the modification of retiree health benefits, which some courts interpret to extend even to retirees with no vested right to the benefits.⁹² The Retiree Benefits Bankruptcy Protection Act of 1988 modified the bankruptcy code to prevent employers acting as a debtor in possession or a trustee

from unilaterally modifying retiree health and life insurance benefits in a Chapter 11 reorganization.⁹³ The Act requires an employer or trustee to negotiate with a representative of the retirees and attempt to reach a settlement before petitioning the bankruptcy court to reduce or eliminate the benefits.⁹⁴ The union that negotiated the benefits or a committee of retirees can serve as the retirees' representative.⁹⁵ The parties can agree to modify the benefits, or if negotiations fail, the employer or trustee can seek approval from the bankruptcy court of a unilateral modification that is required to enact a reorganization of the employer that is fair and equitable to all creditors.⁹⁶ Some bankruptcy courts deny these special protections to retirees whose health benefits are not vested, in which case the employer acting as debtor in possession or the trustee can terminate or reduce the benefits without negotiation, but other bankruptcy courts will require the procedures to be followed.⁹⁷

Ultimately, the retirees' representative and the employer or trustee may negotiate the establishment of a VEBA rather accepting continuing, reduced benefits provided directly by the employer. The amount contributed to the VEBA is presumably secure from the other creditors in the event of a liquidation, though it may include substantial amounts of the reorganized company's stock. The Retirees Committee of bankrupt auto-parts maker Dana Corporation recently negotiated such a contribution to a VEBA.⁹⁸ The Steelworkers union has also negotiated retiree health benefit VEBAs with several companies in the declining steel industry.⁹⁹ When vested retiree health benefits are involved, the effect of these negotiations in bankruptcy is to release the employer from its obligation to provide those benefits and shift responsibility for providing them to the VEBA. Though this is a significant change from the original agreement between the employer and the retirees, these transfers are less revolutionary and quite different from arrangements like the proposed UAW-automaker deals, discussed below. In bankruptcy all

unsecured creditors of the insolvent employer will likely have to compromise—not just retirees—and bankruptcy courts, which have experience in the equitable distribution of assets to creditors, have oversight over any unilateral modification.

VEBAs Negotiated to Provide Retiree Health Benefits to Unvested Employees or Retirees

Assuming employees' or retirees' rights to health benefits in retirement have not already vested, an employer can choose to offer retiree health benefits that are derived from its limited contributions to a VEBA instead of directly providing benefits from its corporate treasury. The employer can simply pledge to contribute funds to the trust and limit its liability to that contribution. Presumably in these situations, the employer could have simply terminated the benefits altogether. Essentially, the employer is making a “defined contribution” to pay for retiree health benefits (the level of benefits the trust can afford), rather than vesting employees with a “defined benefit,” a certain guaranteed level of health benefits that will be provided by the employer.¹⁰⁰ Since the employees or retirees never had a vested right to a fixed level of benefits provided directly from the employer in the first place, under this approach no employee's or retiree's vested rights are altered.

A modified version of this approach has been the source of litigation, but it is not the VEBA that is the source of controversy, though its use as a financing vehicle may cloud the issues in the case. An employer and union might agree that future retirees will continue to be covered under the employer's health insurance plan for life, but the employer will cap the amount it will pay towards the retiree's premiums every year. The employer may concurrently agree to make a lump sum contribution to a VEBA, administered jointly by the employer and the union, that will offset the premium that retirees must pay.¹⁰¹ Upon retirement, employees will have a vested right to health coverage offered by the employer that is limited by the cap on what

the employer will contribute towards their premium, but the VEBA will pay all or part of the employee's share of the premiums until its funds are exhausted.

In these situations, when the VEBA does run out of money, questions may still remain as to precisely what benefits employees had a vested right to in retirement, but the litigation does not turn on the existence of the VEBA itself. Heavy equipment manufacturer Caterpillar claims it unilaterally implemented a cap on the premium payments it would pay on behalf of future retirees in 1992, while it was at bargaining impasse with the union. It later agreed with the union to finance the difference between what it would pay for premiums and actual premiums with a VEBA trust in 1998.¹⁰² The VEBA's funds ran out in 2004, at which time Caterpillar threatened to commence charging retirees a share of the premium.¹⁰³ Retirees and surviving spouses brought suit against Caterpillar asserting that they had a vested right to receive fully-funded retiree health benefits.¹⁰⁴ The central issue in the case does not concern the VEBA itself, but whether the employer can impose the caps; the VEBA financing merely delayed the conflict. A Caterpillar spokeswoman explained to *The Detroit Free Press* that the trust was only intended to be a temporary solution.¹⁰⁵ Even the union's negotiator on the deal asserted that the VEBA had served its purpose.¹⁰⁶ The litigation is still ongoing.¹⁰⁷

Another frequently cited VEBA "failure" involves the Detroit Diesel Corporation, which established a VEBA with the UAW in 1993.¹⁰⁸ The employer and the union agreed that for employees retiring after 1993, the company would cap how much it would pay of retiree health premiums and the VEBA would pay the premiums in excess of the company's contribution.¹⁰⁹ This arrangement continued until the VEBA ran out of funds in 2004.¹¹⁰ At the time the VEBA was established, the parties apparently did not conclusively settle the question of what would happen in the event the VEBA exhausted its funds—whether the benefits remained fully vested

and the employer maintained an obligation to make continuing contributions to the VEBA, or if the caps were a definitive limitation of the employer's retiree health liability. When the employer notified the retirees that they would have to pay the excess premiums, some brought suit claiming that their right to fully funded retiree health benefits, without a retiree premium contribution, was vested by the collective bargaining agreements immediately prior and subsequent to the agreement that established the VEBA.¹¹¹ A federal district court granted a preliminary injunction preventing modification of the benefits, and the Sixth Circuit affirmed the injunction.¹¹²

In both the *Caterpillar* and *Detroit Diesel* cases, even though the VEBAs exhausted their funds, the legal rights of the parties did not necessarily change because the employer had adopted the VEBA as a source of financing. The controversies center on the language of the collective bargaining agreements that defined the retiree health benefits. When the employer finally made concrete modifications to the benefits, the retirees brought suit seeking to clarify the benefits offered in the original agreements, just as they could have done if the employer modified benefits that it had been paying for directly. These situations therefore are fundamentally different than the pending automaker-UAW VEBA arrangements, which, as discussed below, propose to override any pre-existing rights created in earlier agreements with a class settlement and replace it with a right to benefits provided from a limited pool of funds contributed to a VEBA trust.

VEBAs Established in Exchange for Releasing Employer of Retiree Health Benefit Obligations

The large pending VEBA deals in the news, including the proposed UAW-automaker VEBAs, are more revolutionary and problematic arrangements than the ones discussed above. These arrangements involve releasing the employer from its obligation to provide arguably vested retiree health benefits and raise questions about whether the interests of the affected

retirees can be adequately represented. Implementing these deals is therefore significantly more complex than deals that tie future, unvested benefits to a VEBA trust or do not alter an employer's fundamental obligation to provide vested retiree health benefits and simply use a VEBA for financing.

Two previous situations provide guidance on how an employer, a union, and representative retirees can successfully release the employer of its putative obligation to provide retiree health benefits in exchange for contributions to a VEBA trust that will take on responsibility for providing the benefits. In both of the deals, however, the employers were only released from a portion of their obligation to provide benefits in exchange for funding the trust.¹¹³ The arrangements approved in the 1993 *Navistar* opinion and the 2007 *McKnight* opinion, involving General Motors and Ford, released the employers' direct liability for providing broad retiree health benefit coverage in exchange for fully-vested, but more limited coverage and a contribution to a VEBA that would partially offset increased retiree responsibility for health care costs under the new less generous plans.¹¹⁴ Notably, the binding effect of settlement approved in *McKnight* was durationally limited until September 2011,¹¹⁵ leaving the question of whether retirees had a vested right to health benefits beyond that date open—an issue that the latest pending deals purport to settle.

Presumably, the process the parties would need to follow to release the employer of all of its putative retiree benefit obligations in exchange for a contribution to a VEBA is the same as the process used to release the employer from a portion of those liabilities. To implement such an arrangement, a union and an employer can first negotiate a proposal to release the employer from its obligation to provide retiree health benefits in exchange for fixed contributions to the VEBA trust.¹¹⁶ Importantly, the union cannot bind the retirees to the agreement; the Supreme

Court has held that retirees, former employees receiving pensions and benefits, are not part of the bargaining unit that the union represents.¹¹⁷ The union instead can select and organize representative retirees and counsel to file a class action seeking declaratory and injunctive relief against the employer's unilateral modification of benefits. The representatives can allege violations of section 301 of the Labor Management Relations Act for breach of the collective bargaining agreement that ostensibly granted them a vested right to benefits, as well as ERISA section 502(a) for benefits due and violations of the plan terms.¹¹⁸ In the UAW-automaker deal that is the subject of *McKnight*, the UAW not only asked certain retirees to act as class representatives, but also suggested a lawyer to server as their class counsel.¹¹⁹ The agreement worked out in advance between the employer and the union can ultimately serve as the employer's settlement offer to the class.¹²⁰

Using an adversarial civil suit to implement an agreement made between the employer and the union, a party that does not even represent the employees, is problematic, especially since only a handful of retirees (those who agreed to represent the class) in essence ratified the agreement. There is no guarantee at this point in the litigation whether the interests of the majority of retirees who will be bound by a class settlement are adequately represented. Federal Rule of Civil Procedure 23, regarding class actions, however, provides some protection.

First, the rule requires the court to monitor the class action process. Specifically, the court must certify the class and appoint class counsel.¹²¹ In this capacity, the court must, among other things, determine that the class representatives will "fairly and adequately protect the interests of the class,"¹²² and evaluate the class counsel to ensure that she will "fairly and adequately represent the interests of the class."¹²³ In *McKnight*, both the district court and the Sixth Circuit on appeal approved the UAW's handpicked class representatives and recommended

counsel.¹²⁴ The circuit court emphasized the counsel's experience and professional and financial independence from the employers and the union.¹²⁵ The court also did not consider the class representatives and counsel's acceptance of the agreement as negotiated between the automakers and the UAW to be improper, asserting that they retained the right to modify the settlement.¹²⁶

Second, a court will examine the substance of the agreement in addition to the settlement process. Rule 23 permits the court to approve the settlement only "after a hearing and on finding that it is fair, reasonable, and adequate."¹²⁷ A court in the Sixth Circuit will weigh several factors in deciding whether a settlement meets this standard,¹²⁸ including "the likelihood of success on the merits weighed against the amount and form of the relief offered in the settlement,"¹²⁹ and "the risks, expense, and delay of further litigation."¹³⁰ In a review of a settlement that releases an employer from its putative obligation to provide retiree health benefits in exchange for a contribution to a VEBA, these factors largely translate into an evaluation of 1) the strength of the parties' claims regarding whether the retirees' right to health benefits was vested,¹³¹ and 2) in the event that the right to benefits was found to be vested, the likelihood that retirees would continue receiving their current health coverage given the financial position of the employers.¹³² The court will also consider and respond to legitimate concerns raised by the objecting members of the class at a hearing and in writing.¹³³

The *McKnight* and *Navistar* courts both approved the class settlements, finding fair the offers of reduced but vested benefits combined with partially offsetting payments from a funded VEBA trust. Both found that the employers, Navistar and the automakers, had a tenable claim that the retirees' rights to health benefits were not vested and could be unilaterally reduced or terminated.¹³⁴ The court of appeals in *McKnight* particularly focused on the risks of litigating the vesting question given the Sixth Circuit's seemingly inconsistent jurisprudence on the issue;

if a court found the benefits were not vested, “little would stand in the way of the car companies’ reducing or even eliminating the retirees’ healthcare benefits in the future.”¹³⁵ Further, both opinions examined the employers’ financial situations and the impact of bankruptcy, which could result in a more significant reduction in benefits even if a court found them to be vested.¹³⁶ In both of the situations, the employers were in financial distress and the cost of retiree health benefits were a significant burden. GM and Ford’s automotive operations had lost billions of dollars in the previous year, having spent billions on retiree health.¹³⁷ Similarly, the *Navistar* court found that because of its \$2.6 billion in retiree health liabilities, the truckmaker would not even survive a reorganization; liquidation would be “the inevitable result” of a rejection of the settlement offer if the retirees’ right to benefits was vested.¹³⁸ As discussed above, reorganization gives employers a limited opportunity to reduce even vested retiree health benefits and liquidation merely leaves retirees with an unsecured claim that would have to be satisfied by the sale of the company’s assets, which would not likely cover a significant amount of their claim.¹³⁹

Obviously, a settlement including a well-financed VEBA that is actuarially forecast to fulfill most of the employer’s original putative retiree health benefit obligation will militate towards court approval. Both the *McKnight* and *Navistar* courts found that given the risk that the retirees would see a drastic reduction in benefits through either a declaration that their rights were not vested or a bankruptcy, a reduced benefits package with a contribution to fund a partially offsetting VEBA trust was a fair, reasonable, and adequate settlement.¹⁴⁰ In approving the settlement, the *Navistar* court specifically noted that the funding of the VEBA, “a truly innovative concept,” was tied to the financial recovery of the employer.¹⁴¹ The agreement entitled the trust to 50% of the company’s common stock plus a share of its future profits.¹⁴²

The court believed that if the employer's performance improved enough, the retiree health benefits could theoretically be restored to their original levels.¹⁴³

This type of arrangement potentially also could arise out of a genuine adversarial dispute between the retirees and the employer, even with retirees who were never represented by a union. For example, an employer could move to terminate or reduce retiree health benefits provided to retired non-union retirees and the retirees could bring a class action under the ERISA enforcement provisions. The employer could negotiate a deal with class counsel that involved settling the claim. The class representatives would agree that the employer is not obligated to provide retiree health benefits (or only provide limited benefits) in exchange for fixed contributions to a VEBA that would provide the benefits. Even former union employees may operate somewhat independently of the union in striking such a deal. For example, metals company AK Steel settled a lawsuit that arose out of a genuine dispute with a class of union retirees over their vested right to retiree health care; the pending settlement agreement relieves the company of its obligation to provide benefits in exchange for a series of contributions to a VEBA that is predicted to cover the retiree health costs that were originally paid for by the employer.¹⁴⁴

III. Motives for and Risks of Shifting Retiree Health Obligations from Employers to VEBAs

Though the biggest pending VEBA deals involve the car and tire manufacturers, the forces driving employers and unions to adopt VEBAs as part of retiree health benefit financing schemes may appear even outside the automobile industry. Some commentators are even predicting that the UAW-automaker agreement signals the beginning of more widespread use of VEBAs for financing employee benefits. *Workforce Management* called the Detroit VEBA

deals the biggest workforce story of the year and predicted that “[t]he health care trusts that made a big splash in 2007 will likely live on in increasing numbers in 2008.”¹⁴⁵ *The Detroit Free Press* predicted that VEBAs would remain “in the spotlight for years.”¹⁴⁶

Given that shifting retiree health benefit responsibility to a VEBA has complex implications arising from ERISA and securities laws and that contributions to the trust are forever out of reach of the employer, it is unsurprising that observers attribute the recent interest in the approach to forces other than the tax advantages. Though it remains to be seen whether there will be many more deals as revolutionary as the agreements to release the automakers from their retiree health benefit liability in exchange for contributions to VEBAs, the concept is part of an undeniable trend away from employer-provided retiree health benefits: the percentage of large employers offering retirees health benefits dropped from 66% to 33% between 1988 and 2007.¹⁴⁷

Three parties have a significant stake in what entity, if any, is responsible for providing retiree health benefits. All of the relevant groups, however, have different motivations. Employers are interested in controlling their liabilities, retirees are interested in maintaining secure health benefits at the highest possible levels, and unions, who purport to speak for retirees and also have a legal obligation to represent in active employees in their bargaining unit, have an interest in satisfying their membership’s desire for job security and wage increases or maintenance. Each of these parties may gain from relieving an employer from the obligation to provide the retiree health benefits in exchange for a contribution to a VEBA that will assume the responsibility, but the most radical of these arrangements, like the pending UAW-automaker deals, are largely negotiated by employers and unions and raise questions about whether the interests of retirees are adequately protected.

Employer Interests

In the opinion approving the settlement that released Navistar from its retiree health benefit obligations in exchange for a contribution to a UAW-sponsored VEBA, the court wrote that the “case, arising out of the de-industrialization of the United States, presents this Court with a tragic situation, which unfortunately and inevitably will be replicated with other manufacturing companies and other workers.”¹⁴⁸ Though the trend may have unfolded more slowly than the court would have predicted, the statement was prescient; today, about fifteen years later, all three automakers and Goodyear are following the same path. Clearly, changes in the domestic manufacturing industry and increases in retiree health benefit costs are at least in part driving the quest for solutions, such as using VBAs. When retiree health benefits were first bargained in the manufacturing industry in the 1950s and 1960s, employers saw the benefits as a relatively costless offer; Medicare’s introduction in 1965 only furthered the perception that the expense of the benefits would be trivial.¹⁴⁹ Over time, however, the cost of retiree health benefits ballooned, while domestic manufacturers increasingly faced competition from foreign automakers. By 2004, retiree health care costs accounted for 70% of all of GM’s health care expenses.¹⁵⁰ These costs hit the Detroit automakers and other domestic manufacturers especially hard because they have as many or more retirees than active workers, so the relative cost of retiree benefits equal or exceed the cost of providing benefits to current workers.¹⁵¹ *The Wall Street Journal* recently reported that hourly compensation costs for domestic automakers in the U.S. total \$65 to \$75, while hourly compensation costs for the non-union U.S. workforces of Asian automakers run only \$45 to \$55, with roughly a third of the difference attributable to retiree health benefit costs.¹⁵²

Accounting conventions played an important role in making these costs more visible. The implementation of accounting practice reforms that emphasized the cost of retiree health benefits anecdotally correspond to periods of interest in using VEBA's to finance the burden. At one time, publicly held employers did not have to account for the accrued value of retiree health benefits obligations in their financial statements. New rules issued by the Financial Accounting Standards Board (FASB), which establishes accounting standards that are recognized as authoritative for public companies by the SEC,¹⁵³ have made the costs more transparent. In 1984, FASB issued Financial Accounting Standard (FAS) 81, which required public companies to disclose in a footnote what retiree health and life benefits they provided and how they accounted for the cost of these benefits.¹⁵⁴ In 1990, FASB issued a standard requiring a uniform disclosure of the cost of retiree health benefits in financial statements. The new standard, FAS 106, required employers to begin accruing the future costs of providing retiree health benefits for their currently active employees, effective the end of 1992.¹⁵⁵ Many observers attribute the significant decline in the number of employers offering retiree health benefits to the issuance of FAS 106.¹⁵⁶ One commentator reports that when the retiree health liabilities were reported in financial statements, domestic automakers' earnings dropped by 35% on average.¹⁵⁷

Anecdotally, FAS 106 motivated employers to seek creative solutions using VEBA's to reduce their employee benefit liabilities. In late 1992, truck-maker Navistar, as discussed above, negotiated the release of some of its retiree health benefit obligations in exchange for a contribution to a VEBA trust.¹⁵⁸ This technique of transferring retiree health obligations to a VEBA can eliminate significant retiree health benefit liabilities on the balance sheet, but requires a cash or stock contribution large enough to satisfy the union and, if arguably vested benefits are at stake, a court. Also at this time, manufacturers Caterpillar and Detroit

Diesel, discussed above, sought to cap their maximum retiree health benefit costs.¹⁵⁹ Detroit Diesel ostensibly intended to shift responsibilities for future retiree health benefit expenses beyond the cap to a VEBA,¹⁶⁰ an approach that would create limited, predictable retiree healthcare liabilities and limit the risks of medical cost inflation. In an opinion from the later litigation regarding Detroit Diesel's retiree obligations for expenses beyond the cap, the court specifically noted that the VEBA was proposed in the parties' discussions of "the impact of FAS 106 on Detroit Diesel's financial position."¹⁶¹

In 2006, FASB promulgated another new standard, FAS 158, that amends FAS 106 and makes the reporting of retiree health care liabilities even more transparent.¹⁶² The new standard requires employers to incorporate its retiree health plan's funding status, based on its projected obligations, into its balance sheet, rather than merely disclosing the liabilities in the footnotes of the financial statement as was permitted under FAS 106.¹⁶³ Some commentators predict that the new standard will have a significant impact on the valuation of public companies and further encourage the offloading of retiree health obligations onto VEBAs established with fixed contributions.¹⁶⁴

In settlements that shift vested retiree health benefit liabilities from an employer to a VEBA, employers have generally been able to offload the obligations for cash and stock contributions worth only a percentage of the present value of the future cost of providing retiree health care, translating into a real balance sheet savings for the employer. For example, the pending 2007 UAW-automakers VEBA agreements propose that the three carmakers will only make contributions of cash and securities equaling \$52 billion, while releasing them from \$88 billion in future retiree health benefit obligations, a payment of less than 60 cents on the dollar.¹⁶⁵ A VEBA may provide reduced benefits compared to what was provided by the

employer to realize some of these savings. Other savings will be purportedly generated by the tax-free investment experience of the trusts or by the more efficient and cost-effective delivery of healthcare. The proposed UAW-automaker VEBA's were negotiated assuming a medical cost inflation rate of only 5% and annual investment returns of 9%.¹⁶⁶ If these figures are accurate, the VEBA ostensibly can provide the promised level of benefits for 80 years.¹⁶⁷ In addition to reducing employer retiree health benefit liabilities that are valued in excess of the employer's contributions, these arrangements also shift the risk of unforeseen healthcare cost inflation and life span increases from the employer to the VEBA, and therefore the retirees, a favorable move for the employers in the eyes of bond rating agencies.¹⁶⁸

However, employers may occasionally stand to lose in VEBA arrangements. First, *Detroit Diesel* and *Caterpillar* illustrate that employers face the risk of litigation when they attempt to negotiate limited retiree health benefit liability for future, ostensibly unvested retirees, in exchange for contributions to a VEBA.¹⁶⁹ If the VEBA exhausts its funds, retirees may seek to show that they already had a vested right to the benefits or that the agreement that established the VEBA concomitantly gave them a vested right to the original level of benefits from the employer, regardless of whether the VEBA or the employer financed the coverage. Second, there is a political risk. If the employer negotiates a release of its liability for providing already vested retiree benefits in exchange for a contribution to a VEBA with court approval, or simply pledges contributions to a VEBA to provide benefits for future or unvested retirees in a collective bargaining agreement, its total VEBA contribution obligation is fixed. That fixed amount could exceed what the employer would have spent to provide the benefits directly if medical cost inflation is very low or if Congress legislates more generous Medicare benefits or expands the program to provide government subsidized care to younger individuals, absorbing

the costs of early retirees. Under the current regulations, the employer would never be able to recover its contribution,¹⁷⁰ even if the actual retiree healthcare costs were very low or Congress establishes a comprehensive single-payer healthcare plan that subsumes many of the costs the VEBA was intended to cover.

Retiree Interests

Though employers generally stand to gain from limiting their responsibility to provide retiree health benefits to fixed contributions to a VEBA, the result of VEBA-only financing of retiree health benefits on retirees is ambiguous. Retiree healthcare coverage is a coveted benefit, even for retirees of the age to qualify for Medicare, which before the introduction of the drug benefit, only paid a little more than half of its beneficiaries' healthcare expenses.¹⁷¹ Designating a VEBA trust, with a limited corpus, as the sole source of retiree health benefit financing shifts the risk of medical inflation from the employer to the VEBA and therefore the retirees. If the retirees' aggregate health benefit expenses exceed expectations or the trust's investment experience is poor, the VEBA trustees will be forced to reduce or eventually eliminate benefits, with no promise of help from the employer no matter how profitable it has become. Determining whether VEBA financing of retiree health benefits is a victory for retirees is therefore heavily dependent on the nuances of the deal and the employer's financial situation.

For employees or retirees who clearly do not have a vested right to retiree health benefits, an agreement that the employer will contribute to a VEBA that will provide retiree health coverage is clearly preferable to the employer's elimination of retiree health coverage altogether and, depending on the financing of the VEBA, may be preferable to unvested retiree benefits that are provided indefinitely by the employer, but can be reduced or terminated at any time. Once the assets are contributed to the VEBA, they cannot revert to the employer,¹⁷² so the retirees

have a guaranteed pool of funding, though how fast it will be depleted depends on the trust's costs and investment earnings.

The position of retirees who have a putatively vested right to retiree health benefits and are in a class that could be bound to a settlement that releases the employer for its obligation to provide those benefits in exchange for a VEBA contribution is even more complicated. In many instances, these retirees may find themselves in a “lose-lose” situation.¹⁷³ For example, if the employer has a strong argument that the retirees do not have a vested right to the benefits, and it retains the ability to modify coverage, then exchanging employer liability for a contribution to a VEBA may be a good deal.¹⁷⁴

Similarly, the near-certain bankruptcy of an employer is a threat to retirees, even those with an undeniably vested right to health benefits. Retiree health benefits are not secured by a government-sponsored scheme, like qualified pension benefits that are insured by the Pension Benefit Guaranty Corporation.¹⁷⁵ If an employer is in financial distress, a VEBA offers retirees a degree of security by serving as a guaranteed, though limited, source of benefit funding that the employer's creditors are unlikely able to reach in bankruptcy. Even considering the healthcare cost inflation and investment experience risk, a VEBA trust with assets sufficient to cover a significant portion of estimated retiree health benefits liabilities—like the proposed UAW-automaker VEBAs—may therefore leave retirees better off than a vested right to benefits from a financially insecure employer.¹⁷⁶ Even if the distressed employer is likely to survive a reorganization, retirees may be able to extract a more generous contribution to a VEBA while the employer is still solvent.

Courts, as discussed above, examine these factors before approving a deal that releases an employer from its obligation to provide putatively vested retiree health benefits in exchange for

fixed contributions to a VEBA. However, questions remain whether this process will adequately protect the retirees. The union that negotiated the deal will certainly argue that it considered the retirees' interests,¹⁷⁷ but it not have the legal authority to represent the retirees¹⁷⁸ and, as discussed below, may be tempted to put the somewhat conflicting interests of active employees first. The court reviewing such a settlement is therefore the primary defender of the retirees.

Certainly, a court will be competent to make a summary evaluation of the relative merits of competing claims regarding whether the retirees' benefits are vested.¹⁷⁹ It is probably less competent though to evaluate the financial position of an employer and determine whether the situation is truly dire enough to justify the settlement when considered in conjunction with the strength of the retirees' argument on the vesting issue. For this analysis, a court might rely on expert testimony produced by class counsel at the fairness hearing.¹⁸⁰ The expert, however, may not be an entirely independent representative of the retirees. In *Navistar*, for instance, at the fairness hearing the class representatives presented as their financial expert an investment banker who had also advised the union in its negotiations with the employer to initially structure the deal.¹⁸¹ A court should be aware of these conflicts and not find "fair, reasonable, and adequate,"¹⁸² any binding class settlement that releases an employer from arguably vested benefits on the basis of the employer's precarious financial condition of the employer, unless credible, unbiased evidence supports the position.

Union Interests

Unions, and the active employees they represent, may too stand to gain from shifting responsibility for retiree health benefits from employers to a VEBA. Recall that some transfers of retiree health benefit responsibilities may only affect current bargaining unit employees, whose right to the benefits in retirement has not yet vested. For example, an employer and a

union may agree that the employer will provide coverage for future retirees, but will only pay up to a certain amount. The parties may agree that the excess cost must be covered through premium payments made by retirees, but that the employer will make fixed contributions to a VEBA to offset that cost to the retirees. Allowing the employer to limit its liability with such an arrangement may be unpopular with the bargaining unit, but it may allow the union to extract other concessions like wage increases or job security that may be more immediately desired by members. Since the union's bargaining committee is presumably still accountable to the active employees that will be impacted by the deal, this situation does not raise extraordinary concerns about conflicts of interest.

More problematic is the situation in which a union negotiates an agreement that releases the employer of its putative obligation to provide retiree health benefits in exchange for a payment to a VEBA. If the retirees have an arguably vested right to those benefits then a court approved class action settlement as discussed above will be a critical component of the arrangement.¹⁸³ The union still has a tremendous amount of influence in the official settlement process. The initial agreement and the union's subsequent organization of the suit that will ratify the arrangement will largely define the terms of the final settlement even though the union does not legally represent the retirees. In both *McKnight* and *Navistar*, the class representatives accepted as the terms of the settlement the framework agreed upon in advance by the union and the employer; both courts then also approved.¹⁸⁴ The *McKnight* court granted its approval despite the union's involvement in choosing the class representatives and recommending the chosen class counsel.¹⁸⁵

The union's interest may in part be aligned with retirees—it probably wants to signal to active employees that union negotiators will consider their interests in the future when they are

retired.¹⁸⁶ However, it may be most concerned with securing pay and job security for its present, active employee membership, perhaps at the expense of getting the best deal for the retirees in the initial negotiations of the retiree health benefit financing agreement. Regarding the recent UAW-automaker deals, at least one industry observer, Daniel Howes of *The Detroit News*, claims that “[i]t was the UAW, backed by the financial savvy of [investment bank] Lazard, that pushed the concept of off-loading billions in retiree health care liabilities to voluntary employees’ beneficiary associations, or VEBAs, to be funded by the companies and controlled by the unions.”¹⁸⁷ Though a degree of security for retirees in the event of an employer bankruptcy might have motivated the deals, releasing the automakers from this liability also might improve the employer’s financing prospects, ultimately leading to better job security and wage increases for active union workers.¹⁸⁸ A union might, therefore, not be motivated to negotiate the best arrangement for its retirees. It may use overly optimistic estimates to calculate healthcare cost inflation and expected investment returns on the trust’s assets,¹⁸⁹ or agree to a contribution to the VEBA of illiquid, noncash assets of questionable value. For example, Howes also claims that “[i]t was the UAW that proposed Ford exchange a portion of its cash contribution to the VEBA for a larger convertible note and then invest the difference in plants, new equipment and flexible body shops. The result: More union jobs in more flexible, more competitive U.S. Ford plants.”¹⁹⁰ As mentioned above, because of this potential for conflict and the power of the union in orchestrating these agreements, courts must scrutinize the settlement terms and the experts used to analyze the situation on behalf of the parties.

Some reports in the media regarding the UAW-automaker deals insinuate that the employer stock that an employer contributes to the VEBA will be under union control.¹⁹¹ This conflict is probably less of a concern than the union’s potentially conflicted position in the initial

negotiation of the contribution. Once the trust and the plan is established, ERISA's clear imposition of fiduciary duties, specifically the duty of loyalty, and enforcement provisions provide beneficiaries with a cause of action if the trustees allow union interests to hamper their representation of the beneficiaries in exercising control of the shares.¹⁹² Further, as discussed in the first section of this paper, since these significant transfers of employer securities likely violate ERISA's prohibited transaction rules, the required administrative exemption will probably impose additional requirements to safeguard the trustees' independence.¹⁹³ Consistent with these statutory restrictions and anticipated administrative requirements, the UAW has pledged that the pending automaker retiree health VEBA will not be governed by the union but by independent trustees "with expertise in health care, financial management and related areas."¹⁹⁴ Additionally, GM's chief financial officer has stated that it was his understanding that the trustees would vote the employer stock in the fund "in the same proportion as all shareholders."¹⁹⁵

While these deals may help the union win concessions for active employees, they may hamper the union's political aims. By negotiating with the automakers to initiate their release from the obligation to provide retiree health benefits, the UAW may in fact be losing these employers as motivated allies in pursuing one of the union's stated social goals: a "single-payer health insurance system that covers the entire country."¹⁹⁶ Some commentators and labor activists fear that with massive retiree health obligations no longer looming the automakers may be less likely to spend their political capital lobbying Congress to put the burden of providing healthcare on the government.¹⁹⁷ For example, three former UAW officials who publically dissented from the automaker VEBA deals urged the present union leadership not to help the automakers "escape their responsibility to their past commitments but to help them convert those

commitments to the common good,” in the form of a “universal, comprehensive, single-payer healthcare” scheme.¹⁹⁸

IV. Conclusion

The news suggests that there will be more agreements in the future that release employers from the responsibility of providing retiree health benefits in exchange for a contribution to a VEBA, consistent with the trend of fewer employers providing health coverage to their retirees. Given the significant medical costs faced by retirees, even those with Medicare coverage, any reduction in retiree benefits resulting from these agreements will contribute to the retiree financial insecurity. Not all arrangements involving VBAs, however, should alarm those concerned about the interests of retirees being protected; some of the deals are perhaps quite beneficial to them. VBAs themselves are flexible financing vehicles with tax advantages that may help offset the rapidly increasing cost of healthcare. Given the requirements of the Code and ERISA, the contributed funds in the trust are dedicated to the benefit of the retirees and protected from employer manipulation, even though they may be inadequate to cover all of the retirees’ healthcare needs.

In bankruptcy, for example, all unsecured creditors and equity holders are expected to share the burden of the employer’s insolvency. A VBA contribution negotiated in these circumstances, especially for retirees who do not have a strong argument that they have a vested right to benefits, appears to be a fair resolution. Outside of insolvency, any contribution to a VBA that will assume the responsibility for providing health benefits to retirees or future retirees without a vested right to them is a much better alternative to an employer’s unilateral termination of benefits, even though rampant medical inflation or poor investment earnings may exhaust those funds while retirees’ healthcare needs remain.

The agreements that raise the greatest concern are those that eliminate an employer's arguably legally-binding obligation to provide retiree health benefits in exchange for a significantly discounted contribution to a VEBA. The few cases approving these types of arrangements illustrate that they are essentially agreements between the employer and the union, with retiree approval a mere procedural hurdle. Certainly, if a court determines that the retirees do not likely have a vested right to employer-provided health benefits, as it is qualified to do, a deal promising secure funding for health benefits is probably fair. Courts need to be especially cautious, however, when a significant justification for the settlement is the employer's threatened insolvency. In these circumstances, no other creditor appears to have been asked to discount their claim. The security of having the funds locked in a VEBA is valuable, but courts must use their authority under Federal Rule of Civil Procedure 23 to ensure that the exchange of a contribution to a VEBA for the release of liability is reasonable. Even though they may have good intentions, unions are invested in keeping the employer afloat to employ their active members; their word alone on the merits of the deal is therefore inadequate to determine if it is fair. In the next few months, because the automaker and Goodyear agreements present these problems, courts will have an opportunity to demonstrate just how much they will scrutinize these deals. Courts should carefully review the arrangements, and demand independent evidence of their reasonableness, to signal to employers and unions in other industries with massive retiree health benefit obligations that, while creative solutions are possible, they will vigilantly guard the interests of retirees.

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- ¹ Tim Higgins & Katie Merx, *Automakers to Revisit Old Idea in UAW Talks*, DETROIT FREE PRESS, Jul. 15, 2007, available at <http://www.freep.com/apps/pbcs.dll/article?AID=/20070715/BUSINESS01/707150645>.
- ² Jeff Green & Elizabeth Hester, *GM, Ford, UAW Dangle \$54 Billion Health Fund Before Wall Street*, BLOOMBERG, Nov. 16, 2007, available at <http://www.bloomberg.com/apps/news?pid=20601103&sid=aB6fUFzhhsUY>.
- ³ Tim Higgins & Katie Merx, *UAW's New Role: Shareholder*, DETROIT FREE PRESS, Nov. 16, 2007, available at <http://www.freep.com/apps/pbcs.dll/artikkel?Dato=20071116&Kategori=BUSINESS01&Lopenr=711160423>.
- ⁴ Letter from Paul Schrade, Warren Davis & Jerry Tucker to Ron Gettelfinger & UAW Big 3 Auto Contract Negotiators, reprinted in N.Y. TIMES, Sep. 16, 2007, available at: <http://www.nytimes.com/2007/09/16/business/17letter.html>.
- ⁵ Chris Kutalik, *Auto Makers Push VEBA Solution for Industry Crisis*, LABOR NOTES, Sep. 2007, available at: <http://www.labornotes.org/node/1248>.
- ⁶ *Shy v. Navistar*, No. C-3-92-333, 1993 WL 1318607, *2 (S.D. Ohio May 27, 1993) (discussing negotiation of Navistar VEBA); Press Release, Goodyear Tire & Rubber, USW Ratifies Agreement with Goodyear; Pact Provides Company Substantial Cost Savings (Dec. 29, 2006), available at: <http://www.goodyear.com/media/pr/23411pl.html>.
- ⁷ Jeff Green & John Lippert, *AT&T, Verizon May Follow GM With Union Health Funds*, BLOOMBERG, Oct. 15, 2007, available at <http://www.bloomberg.com/apps/news?pid=20601203&sid=arvIIXXJQfQM#>.
- ⁸ *Id.*
- ⁹ Samuel Halpern, *Funding Retiree Healthcare Liabilities*, 23 J. COMPENSATION & BENEFITS 4 (2007).
- ¹⁰ Walter M. Miller, *VEBAs May Be the Solution for Client's Welfare Benefit Plans*, 7 J. TAX'N EMPLOYEE BENEFITS 35 (1999).
- ¹¹ The VEBA, however, is taxed on any "unrelated business taxable income," pursuant to I.R.C. § 501(b). David S. Dunkle, *VEBAs and Other Self Insured Arrangements*, 395-2d T.M. A-30(3) (2006).
- ¹² Joe Guy Collier, *Safety Net for Health Benefits*, DETROIT FREE PRESS, Dec. 23, 2007, available at <http://www.freep.com/apps/pbcs.dll/article?AID=/20071223/BUSINESS01/712230618>.
- ¹³ Treas. Reg. 1.501(c)(9)-3; Miller, *supra* note 10, at 37-38.
- ¹⁴ I.R.C. § 501(a),(c)(9).
- ¹⁵ Treas. Reg. § 1.501(c)(9)-1.
- ¹⁶ *Id.* § 1.501(c)(9)-2(a)(1).
- ¹⁷ *Id.* §§ 1.501(c)(9)-2(b)(2), (3).
- ¹⁸ *Id.* § 1.501(c)(9)-2(a)(1).
- ¹⁹ *Id.* § 1.501(c)(9)-2(a)(2).
- ²⁰ *Id.* § 1.501(c)(9)-2(c)(1).
- ²¹ Treasury Regulation § 1.501(c)(9)-2(c)(3) specifically allows the entity to be controlled by its membership, independent trustees, or a combination of fiduciaries "at least some of whom are designated by, or on behalf of, the membership." The provision deems employer designees independent trustees if the organization meets the definition of an employee welfare benefit plan under ERISA and is therefore subject to that statute's fiduciary requirements. See Dunkle, *supra* note 11, at A-21.
- ²² The transfer of funds from employers to unions is generally prohibited by § 302 of the Labor Management Relations Act, codified at 29 U.S.C. § 186. Section 302(c)(5) of the Act provides for joint union-management welfare benefit trust funds that meet certain restrictions. In particular, section 302(c)(5)(B) requires that "employees and employers [be] equally represented in the administration of such fund." A transfer of funds from an employer to an exclusively union-sponsored trust that provides retiree health benefits is perhaps therefore not exempted under the rules providing for jointly-managed welfare benefit funds; it is probably excepted, however, when the transfer is made pursuant to bankruptcy or as a settlement to a class action, and therefore covered by a different exception outlined section 302(c)(2). The class actions, discussed below, have not been adversarial. Some practitioners are concerned that these settlements therefore do not satisfy the exception because "both sides want the VEBA and the settlement and order are just form over substance." E-mail from Greg Needles, Morgan, Lewis & Bockius (Oct. 29, 2007, 07:16 EDT) (on file with author).
- ²³ ERISA § 403(a), 29 U.S.C. § 1103.
- ²⁴ Treas. Reg. § 1.501(c)(9)-2(c)(2).
- ²⁵ *Id.* § 1.501(c)(9)-3(c). Life insurance, and a limited range of other benefits, are also permitted. Treas. Reg. §§ 1.501(c)(9)-3(b), (d).
- ²⁶ Treas. Reg. § 1.501(c)(9)-4(a).

²⁷ Treas. Reg. § 1.501(c)(9)-4(a).

²⁸ *Id.* § 1.501(c)(9)-4(b). In addition to the requirements outlined in § 501(c)(9) regulations regarding highly-compensated employees, VEBAs must also meet the extensive non-discrimination requirements of I.R.C. § 505.

²⁹ Treas. Reg. § 1.501(c)(9)-4(d).

³⁰ *Id.*

³¹ *Id.*

³² See Miller, *supra* note 10, at 35.

³³ Dunkle, *supra* note 11 at A-15 n.119.

³⁴ FRED GIGLIOTTI & JOHN MARIEN, INTERNAL REVENUE SERVICE, VEBA AWARENESS 8 (1998), available at www.irs.gov/pub/irs-utl/lesson5.pdf. See also ROBERT FONTENROSE & JAY ROTZ, INTERNAL REVENUE SERVICE, THE DEPTHS OF 419 AND 419A, 1-2 (1992), available at: <https://www.irs.ustreas.gov/pub/irs-tege/eotopicj92.pdf> (discussing employer tax abuses of VEBAs).

³⁵ *Id.* at 5 (citing I.R.C. §§ 162, 461)

³⁶ *Id.* at 7-8. See also H.R. REP. NO. 861, at 1154 (1984) (Conf. Rep.), as reprinted in Dunkle, *supra* note 11, at B-1101.

³⁷ *Id.*

³⁸ H.R. 4170, 98th Cong. (1984) (enacted).

³⁹ I.R.C. § 419(a)-(c).

⁴⁰ I.R.C. § 419A(c)(2).

⁴¹ See GIGLIOTTI, *supra* note 34, at 22 (explaining the Service’s position that an employer could not take a deduction for making a contribution that resulted in the “full funding of the entire present value of benefits for current retirees,” but conceding that the two leading cases on § 419 and § 419A, *General Signal v. Commissioner*, 103 T.C. 216 (1994), *aff’d*, 142 F.3d 546 (2d Cir. 1998), and *Parker-Hannifin v. Commissioner*, 72 T.C.M. 191 (1996), *aff’d in part and rev’d in part*, 139 F.3d 1090 (6th Cir. 1998), did not reach the question).

⁴² 120 T.C. 69 (2003). See *Retiree Health Benefits—The Divergent Paths*, in 61 NEW YORK UNIVERSITY ANNUAL INSTITUTE ON FEDERAL TAXATION § 8.06, [4] (2003) (explaining the interaction of *General Signal*, *Parker-Hannifin*, and *Wells-Fargo* and the cases’ impact on the understanding of sections 419 and 419A).

⁴³ 120 T.C. at 81.

⁴⁴ *Id.* at 98.

⁴⁵ GIGLIOTTI, *supra* note 34, at 22.

⁴⁶ I.R.C. § 419A(f)(5).

⁴⁷ H.R. REP. NO. 861, *supra* note 36, at 1158.

⁴⁸ Treas. Reg. § 1.419A-2T, A-2(2), (4).

⁴⁹ *Id.* § 1.419A-2T, A-2(3).

⁵⁰ See Halpern, *supra* note 9; U.S. SECURITIES AND EXCHANGE COMMISSION, RULE 144: SELLING RESTRICTED AND CONTROL SECURITIES (2003), available at: <http://www.sec.gov/investor/pubs/rule144.htm>.

⁵¹ U.S. SECURITIES AND EXCHANGE COMMISSION, RULE 144; 17 C.F.R. § 230.144(e)(1). Other securities rules may also come into effect. The *Wall Street Journal* reports that SEC pre-clearance review will be required before the UAW-automaker VEBA implementation is finalized. Terry Kosdrosky & Jeffrey McCracken, *Ford Expects to See Health Savings Ahead of Rivals*, WALL ST. J., Nov. 16, 2007, at A10.

⁵² Treas. Reg. § 1.501(c)(9)-7.

⁵³ ERISA § 3(1), 29 U.S.C. § 1002(1).

⁵⁴ *Id.* § 3(4), § 1002(4).

⁵⁵ *Id.* § 3(2), § 1002(3).

⁵⁶ Dunkle, *supra* note 11, at A-28.

⁵⁷ ERISA § 502, 29 U.S.C. § 1132.

⁵⁸ *Id.* §§ 201(1), 301(a)(1), §§ 1051(1), 1081(a)(1).

⁵⁹ Higgins, *supra* note 3.

⁶⁰ *A Message to GM Retirees*, UAW GM Report (Sept. 2007), available at: <http://www.uaw.org/contracts/07/gm/index.php>; *Voluntary Employee Beneficiary Association on Behalf of UAW Ford Retirees*, UAW FORD REPORT (Nov. 2007), available at: http://www.uaw.org/contracts/07/Ford/hrly/ford_hr11.php; *Voluntary Employee Benefit Association on Behalf of UAW Chrysler Retirees*, UAW CHRYSLER NEWSGRAM (Oct. 2007), available at: http://www.uaw.org/contracts/07/chrysler/hrly/chry_hr06.php. Collectively hereinafter UAW Reports.

⁶¹ Press Release, Goodyear Tire & Rubber Co., New Goodyear Labor Agreement Reduces Cost, Improves Competitiveness and Protects Health Care (Dec. 22, 2006), *available at*: <http://www.goodyear.com/media/pr/23410pl.html>.

⁶² *Id.* § 406(a), § 1106(a) (prohibited transaction rules); *Id.* § 3(14), § 1002(14) (defining an employer as a party in interest).

⁶³ *Id.* § 408(e), § 1108(e) (permitting plans to hold qualified employer securities provided they are acquired by the plan at a price “not less favorable” than market price, with no commission, and which is not prohibited by § 407(a)).

⁶⁴ *Id.* § 407(a)(2), § 1107(a)(2).

⁶⁵ ERISA section 407(e), 29 U.S.C. § 1107(e), provides the criteria that marketable obligations like debentures must meet to be deemed qualified employer securities that are covered by the 408(e) exemption. The section emphasizes the availability of a liquid market to value such securities. It is unclear whether there is such a market for either the Ford and GM debentures or the warrant offered by privately-held Chrysler.

⁶⁶ Halpern, *supra* note 9.

⁶⁷ ERISA § 408(a), 29 U.S.C. § 1108(a). Pursuant to the statute, the Labor Department has also issued detailed regulations on applying for the exemption. 29 C.F.R. § 2570.30-52.

⁶⁸ Prohibited Transaction Exemption 93-69, 58 Fed. Reg. 51,105 (Sept. 30, 1993).

⁶⁹ Notice of Proposed Amendments to Prohibited Transaction Exemption 93-69, 63 Fed. Reg. 33,732, 33,732-33 (Jun. 19, 1998) (explaining circumstances surrounding original exemption).

⁷⁰ 58 Fed. Reg. 51,105, 51,105.

⁷¹ *Id.* at 51,105-06.

⁷² *Id.* at 51,106.

⁷³ Prohibited Transaction Exemption 2006-19, 71 Fed. Reg. 70,992 (Dec. 7, 2006) (Kaiser Aluminum).

⁷⁴ *Id.* at 70,994-95.

⁷⁵ KAISER FAMILY FOUNDATION & HEWITT ASSOCIATES, *supra* note 147, at 12.

⁷⁶ See Brian J. O’Connor, Most Call VEBA Good, DETROIT NEWS, Sep. 27, 2007, *available at*: <http://www.detnews.com/apps/pbcs.dll/article?AID=/20070927/AUTO01/709270409> (“[c]ritics point to VEBAs at Caterpillar and Detroit Diesel [which were not created pursuant to a class action settlement] that ran out of cash”); Chris Kutalik, *Auto Makers Push VEBA Solution for Industry Crisis*, LABOR NOTES, *available at*: <http://www.labornotes.org/node/1248> (labor activist magazine comparing VEBAs that were not created pursuant to a class action settlement to the 2007 proposed GM-UAW VEBA).

⁷⁷ See Employee Benefits Security Administration, Can the Retiree Health Benefits Provided by Your Employer Be Cut? (2006), *available at*: <http://www.dol.gov/ebsa/pdf/retireehealthbenefits.pdf>.

⁷⁸ See *Employer’s Decision to Discontinue or Change Retiree Health Benefits*, 1 EMP. COORD. BENEFITS § 5.72 (2007).

⁷⁹ *Id.*

⁸⁰ Pamela A. MacLean, *Are Companies Bound by Promises of Lifetime Benefits?*, NAT’L L. J., July 12, 2006, *available at*: <http://www.law.com/jsp/article.jsp?id=1152608728017>.

⁸¹ 716 F.2d 1476 (6th Cir. 1983), *cert. den.* 465 U.S. 1007 (1984).

⁸² *Id.* at 1480 (emphasis removed, ellipsis in original).

⁸³ *Id.* at 1482.

⁸⁴ See, e.g., Douglas Sondgeroth, *High Hopes: Why Courts Should Fulfill Expectations of Lifetime Retiree Health Benefits in Ambiguous Collective Bargaining Agreements*, 42 B.C. L. REV. 1215, 1231 (2001). Note that other commentators believe that recent cases have overruled the *Yard-Man* inference in the Sixth Circuit. James P. Baker, *Who Killed Yard-Man?*, JONES DAY COMMENTARIES, April 2007, *available at*: http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=S4155#_edn66 (citing *Yolton v. El Paso Tennessee Pipeline Company*, 435 F.3d 571 (6th Cir. 2006), which stated, “[t]his Court has never inferred an intent to vest benefits in the absence of either explicit contractual language or extrinsic evidence indicating such an intent.”)

⁸⁵ Sondgeroth, *supra* note 84, at 1238.

⁸⁶ 217 F.3d 539 (7th Cir. 2000).

⁸⁷ *Id.* at 543-44.

⁸⁸ *UAW v. General Motors*, 497 F.3d 615, 631 (6th Cir. 2007).

⁸⁹ *Id.* at 631-32.

⁹⁰ *Shy v. Navistar Int’l Corp.*, No. C-3-92-333, 1993 WL 1318607, *7-*8 (S.D. Ohio 1993); Leslie T. Gladstone, *Retiree Benefits Bankruptcy Protection Act Of 1988: Welfare Benefits In Need Of Reform*, 65 AM. BANKR. L.J. 427, 452-53 (1991).

⁹¹ See *Navistar*, 1993 WL 1318607 at *12 n.25 (explaining that in liquidation of Eastern Airlines, retirees only received 10% of the value of their benefits, and in Pan Am liquidation retirees only received 3% of the value of their benefits).

⁹² See *In re Farmland Indus. Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003).

⁹³ 11 U.S.C. §§ 1114, 1129(a)(13).

⁹⁴ *Id.* § 1114(e)(1), (f)(1).

⁹⁵ *Id.* § 1114(b), (c).

⁹⁶ *Id.* § 1114(e)(1), (g).

⁹⁷ See *In re Dorskocil Companies Inc.*, 130 B.R. 870 (Bankr. D. Kan. 1991) (finding that debtor in possession employer did not have to follow section 1114 procedures before it reduced benefits under a retiree benefit plan for non-union salaried employees that it reserved the right to modify); *but see In re Farmland Indus. Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003) (finding that section 1114 applies to covered retiree benefits plans “regardless of whether the debtor has a right to unilaterally terminate the benefits”).

⁹⁸ Jewel Gopwani, *Dana Posed to Exit Bankruptcy*, Detroit Free Press, Dec. 28, 2007, available at:

<http://www.freep.com/apps/pbcs.dll/article?AID=/20071228/BUSINESS01/712280321/>; Philip Nussel, *Dana Accepts Centerbridge Proposal Over Appaloosa*, RUBBER & PLASTICS NEWS, Oct. 22, 2007.

⁹⁹ Collier, *supra* note 12. See also, e.g., Press Release, United Steel Workers, Union Announces Lowered Costs for Republic VEBA Participants (Dec. 20, 2007), available at: <http://www.usw.org/usw/program/content/4447.php>; Press Release, United Steel Workers, Steelworker Retirees to Receive Health Care Benefit Checks (Sep 14, 2007), available at: <http://www.usw.org/usw/program/content/4253.php>.

¹⁰⁰ Teresa Ghilarducci, *The New Treaty of Detroit: Are Voluntary Employee Benefits Associations Organized Labor’s Way Forward, or the Remnants of a Once Glorious Past?*, New Labor Market Institutions and the Public Policy Response: A Symposium to Honor Lloyd Ulman 9-10 (Oct. 26, 2007), available at: <http://iir.berkeley.edu/~iir/events/fall07/symposium/ghilarducci.pdf> (cited with permission).

¹⁰¹ See *Wood v. Detroit Diesel Corp.*, 213 Fed. Appx. 463, 464-65 (6th Cir. 2007) (describing a arrangement like the hypothetical one).

¹⁰² *Winnett v. Caterpillar, Inc.*, 496 F. Supp. 2d 904, 914 (M.D. Tenn. 2007).

¹⁰³ *Id.* at 914.

¹⁰⁴ *Id.*; *Winnett v. Caterpillar, Inc.*, No. 3:06-cv-00235, 2007 U.S. Dist Lexis 53096 (M.D. Tenn. 2007) (certifying class).

¹⁰⁵ Collier, *supra* note 12.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Wood v. Detroit Diesel Corp.*, 213 Fed. Appx. 463, 464 (6th Cir. 2007).

¹⁰⁹ *Id.* at 464-65.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 465.

¹¹² *Wood v. Detroit Diesel Corp.*, No. 05-74106, 2005 WL 3579169 (E.D. Mich. 2005), *aff’d* 213 Fed. Appx. 463 (6th Cir. 2007).

¹¹³ *UAW v. General Motors*, 497 F.3d 615 (6th Cir. 2007) [hereinafter *McKnight*]; *Shy v. Navistar Int’l Corp.*, No. C-3-92-333, 1993 WL 1318607 (S.D. Ohio 1993).

¹¹⁴ *Id.*

¹¹⁵ *McKnight*, 497 F.3d at 625.

¹¹⁶ See *McKnight*, 497 F.3d at 621-22; *Navistar*, 1993 WL 1318607 at *2-*3.

¹¹⁷ *Allied Chem. & Alkali Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 172 (1971).

¹¹⁸ See *UAW v. General Motors*, No. 05-CV-73991-DT, 2006 WL 891151, *2 (E.D. Mich. 2006), *aff’d* 497 F.3d 615 (6th Cir. 2007).

¹¹⁹ *McKnight*, 497 F.3d at 623.

¹²⁰ See *Id.* at 623; *Navistar*, 1993 WL 1318607 at *4; Complaint, *UAW v. General Motors*, No. 2:07-cv-14074, 2007 WL 3083629 (E.D. Mich. Sep. 26, 2007).

¹²¹ FED. R. CIV. P. 23.

¹²² FED. R. CIV. P. 23(a)(4).

¹²³ FED. R. CIV. P. 23(g).

¹²⁴ *McKnight*, 497 F.3d at 625-29.

¹²⁵ *Id.* at 625.

¹²⁶ *Id.* at 628.

¹²⁷ FED. R. CIV. P. 23(g).

¹²⁸ The district court in the *McKnight* litigation considered eight factors: “i. the likelihood of success on the merits weighed against the amount and form of the relief offered in the settlement; ii. the risks, expense, and delay of further litigation; iii. the judgment of experienced counsel who have competently evaluated the strength of their proofs; iv. the amount of discovery completed and the character of the evidence uncovered; v. whether the settlement is fair to the unnamed class members; vi. objections raised by class members; vii. whether the settlement is the product of arm’s length negotiations as opposed to collusive bargaining; and viii. whether the settlement is consistent with the public interest.” *UAW v. General Motors*, No. 05-CV-73991-DT, 2006 WL 891151, *14 (E.D. Mich. 2006), *aff’d* 497 F.3d 615 (6th Cir. 2007).

¹²⁹ *See id.* *15-17.

¹³⁰ *See id.* at *17.

¹³¹ *See McKnight*, 497 F.3d at 631-32; *Navistar*, 1993 WL 1318607 at *3, *7-8.

¹³² *See McKnight*, 497 F.3d at 632; *Navistar*, 1993 WL 1318607 at *6-8.

¹³³ *Navistar*, 497 F.3d at *11.

¹³⁴ *McKnight*, 497 F.3d at 631-32; *Navistar*, 1993 WL 1318607 at *3, *7-8.

¹³⁵ *McKnight*, 497 F.3d at 631-32.

¹³⁶ *See McKnight*, 497 F.3d at 632; *Navistar*, 1993 WL 1318607 at *6-8.

¹³⁷ *McKnight*, 497 F.3d at 632.

¹³⁸ *Navistar*, 1993 WL 1318607 at *7.

¹³⁹ *See id.* at *8.

¹⁴⁰ *Id.* at *1, *McKnight*, 497 F.3d at 637.

¹⁴¹ *Navistar*, 1993 WL 1318607 at *4.

¹⁴² *Id.*

¹⁴³ *Id.* at n.4.

¹⁴⁴ Jessica Lander-Heffner, *Deadline is Set for AK Retirees to File Objection*, MIDDLETOWN J., Dec. 19, 2007, <http://www.middletownjournal.com/hp/content/oh/story/news/local/2007/12/18/hjn121907aksuit.html>.

¹⁴⁵ Jeremy Smerd, *Top 5 Headlines: Workforce News*, WORKFORCE MGMT., Dec. 10, 2007 (predicting that labor and management in old line industries, as well as local governments, would increasingly adopt retiree health VEBAs).

¹⁴⁶ Collier, *supra* note 12.

¹⁴⁷ KAISER FAMILY FOUNDATION & HEWITT ASSOCIATES, RETIREE HEALTH BENEFITS EXAMINED 1 (2006) (reporting that between 1988 and 2006, the percentage of large firms offering health benefits dropped from 66% to 35%), *available at*: <http://www.kff.org/medicare/upload/7587.pdf>; KAISER FAMILY FOUNDATION & HEALTH RESEARCH & EDUCATIONAL TRUST, EMPLOYER HEALTH BENEFITS: 2007 ANNUAL SURVEY 6 (2007) (reporting that the percentage of large firms offering retiree health benefits dropped from 35% to 33% between 2006 and 2007), *available at*: <http://www.kff.org/insurance/7672/upload/76723.pdf>.

¹⁴⁸ *Shy v. Navistar Int’l Corp.*, No. C-3-92-333, 1993 WL 1318607, *1 (S.D. Ohio 1993).

¹⁴⁹ Randall K. Abbott, *Retiree Healthcare Benefits: A Collision of Social and Shareholder Responsibilities*, 23 J. COMPENSATION & BENEFITS 3 (2007).

¹⁵⁰ Ghilarducci, *supra* note 100, at 15.

¹⁵¹ *See Id.* at 16 tbl. 1 (Noting that the domestic automakers have as many to 2.5 times as many retirees as active employees, compared to Toyota’s U.S. operations that only has a nominal number of retirees who receive a \$3,000 per year to purchase health insurance.)

¹⁵² Joseph B. White, John D. Stoll & Jeffrey McCracken, *GM Labor Deal Ushers in New Era for Auto Industry*, WALL ST. J. A1, Sep. 27, 2007.

¹⁵³ FINANCIAL STANDARDS ACCOUNTING BOARD, FACTS ABOUT FASB 1 (2007), *available at*: http://www.fasb.org/facts/facts_about_fasb.pdf.

¹⁵⁴ Abbott, *supra* note 149; FINANCIAL ACCOUNTING STANDARDS BOARD, SUMMARY OF STATEMENT NO. 81: DISCLOSURE OF POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS (1984), *available at*: <http://www.fasb.org/st/summary/stsum81.shtml>.

¹⁵⁵ Abbott, *supra* note 149; FINANCIAL ACCOUNTING STANDARDS BOARD, SUMMARY OF STATEMENT NO. 106: EMPLOYERS’ ACCOUNTING FOR POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (1990), *available at*: <http://www.fasb.org/st/summary/stsum106.shtml>.

¹⁵⁶ Abbott, *supra* note 149; Ghilarducci, *supra* note 150, at 13.

¹⁵⁷ Ghilarducci, *supra* note 150, at 14.

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- ¹⁵⁸ *Shy v. Navistar*, No. C-3-92-333, 1993 WL 1318607, *4 (S.D. Ohio 1993).
- ¹⁵⁹ *Winnett v. Caterpillar, Inc.*, 496 F. Supp. 2d 904, 911-12 (M.D. Tenn. 2007) (employer ostensibly imposed caps unilaterally in March 1992, after impasse was reached in negotiations that began in the fall of 1991); *Wood v. Detroit Diesel Corp.*, No. 05-74106, 2005 WL 3579169, *1 (E.D. Mich. 2005), *aff'd* 213 Fed. Appx. 463 (6th Cir. 2007) (negotiations began in 1992).
- ¹⁶⁰ *Wood*, 2005 WL 3579169 at *3.
- ¹⁶¹ *Id.* at *1.
- ¹⁶² Halpern, *supra* note 9; FINANCIAL ACCOUNTING STANDARDS BOARD, SUMMARY OF STATEMENT NO. 158: EMPLOYERS' ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS—AN AMENDMENT OF FASB STATEMENTS NO. 87, 88, 106, AND 132(R) (2006), *available at*: <http://www.fasb.org/st/summary/stsum158.shtml>.
- ¹⁶³ Daniel C. Hagen et al., Jones Day, *New Pension Funding and Accounting Rules Barrage Employers: Credit Agreement and SEC Disclosure Impact*, JONES DAY COMMENTARIES, Oct. 2006, at 2.
- ¹⁶⁴ *See* Halpern, *supra* note 7.
- ¹⁶⁵ Katie Merx, *UAW Health Trust Faces Big Doubts*, DETROIT FREE PRESS, Dec. 23, 2007, *available at*: <http://www.freep.com/apps/pbcs.dll/article?AID=/20071223/BUSINESS01/712230617/0/NEWS07>.
- ¹⁶⁶ Merx, *supra* note 165.
- ¹⁶⁷ *Id.*
- ¹⁶⁸ Press Release, Fitch Ratings Ltd., Chrysler LLC Ratings Unaffected by UAW Agreement (Nov. 7, 2007), *available at*: <http://www.businesswire.com/news/home/20071107006521/en>.
- ¹⁶⁹ *See* *Winnett v. Caterpillar, Inc.*, 496 F. Supp. 2d 904 (M.D. Tenn. 2007); *Wood v. Detroit Diesel Corp.*, No. 05-74106, 2005 WL 3579169 (E.D. Mich. 2005), *aff'd* 213 Fed. Appx. 463 (6th Cir. 2007).
- ¹⁷⁰ *See* Treas. Reg. Treas. Reg. § 1.501(c)(9)-4(a).
- ¹⁷¹ CRAIG CAPLAN, AARP PUBLIC POLICY INSTITUTE, WHAT SHARE OF BENEFICIARIES' TOTAL HEALTH CARE COSTS DOES MEDICARE PAY? tbl. 1 (2002), *available at*: http://assets.aarp.org/rgcenter/health/dd78_costs.pdf.
- ¹⁷² *See* Treas. Reg. Treas. Reg. § 1.501(c)(9)-4(a).
- ¹⁷³ *Shy v. Navistar Int'l Corp.*, No. C-3-92-333, 1993 WL 1318607, *1 (S.D. Ohio 1993).
- ¹⁷⁴ *See* UAW Reports, *supra* note 60 (explaining that the automakers took the position that they retained the right to modify retiree benefits and that UAW accepted VEBA proposal, despite arguing that benefits were vested, in part because of risk that a court may agree with the automakers).
- ¹⁷⁵ ERISA § 4021, 29 U.S.C. § 1321(a) (limiting plan termination insurance coverage to pension plans).
- ¹⁷⁶ Sholnn Freeman, *Union Picks GM to Lead Contract Talks*, WASH. POST, Sep. 14, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/09/13/AR2007091302437_pf.html (quoting University of California-Berkeley labor scholar Harley Shaiken as saying that the proposed 2007 UAW-automaker VEBA deal “might be less risky for the union than the system currently in place, simply because the financial shape of the Detroit automakers is precarious.”)
- ¹⁷⁷ *See* UAW Reports, *supra* note 60.
- ¹⁷⁸ *See* *Allied Chem. & Alkali Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 172 (1971).
- ¹⁷⁹ *See* *UAW v. General Motors*, 497 F.3d 615, 631 (6th Cir. 2007) [hereinafter *McKnight*] (summarizing parties arguments regarding vesting in light of court's own caselaw on the issue).
- ¹⁸⁰ *Shy v. Navistar Int'l Corp.*, No. C-3-92-333, 1993 WL 1318607, *4 (S.D. Ohio 1993).
- ¹⁸¹ *Id.* at *2, *4 n.10.
- ¹⁸² FED. R. CIV. P. 23(e)(2).
- ¹⁸³ *See* *McKnight*, 497 F.3d 615; *Navistar*, 1993 WL 1318607.
- ¹⁸⁴ *McKnight*, 497 F.3d at 628-29; *see* *Navistar*, 1993 WL 1318607 at *4.
- ¹⁸⁵ *McKnight*, 497 F.3d at 627.
- ¹⁸⁶ Ghilarducci, *supra* note 100, at 17 (noting the UAW traditionally “had a high degree of intergenerational solidarity”).
- ¹⁸⁷ Daniel Howes, *UAW Gives Big Three Chance at Reinvention*, DETROIT NEWS, Nov. 5, 2007 at A1, *available at*: <http://www.detnews.com/apps/pbcs.dll/article?AID=/20071105/OPINION03/711050349/1008/opinion01>.
- ¹⁸⁸ *See* Bryce G. Hoffman & Daniel Howes, *Ailing Ford Gets Deal That Fits Its Needs*, DETROIT NEWS, Nov. 5, 2007 at A1, *available at*: <http://detroitnews.com/apps/pbcs.dll/article?AID=/20071105/AUTO01/711050348> (Quoting UAW president Ron Gettelfinger as saying, “[i]f Ford is stronger, that will make our membership more secure.”)

¹⁸⁹ Cf. Merx, *supra* note 165 (Quoting a VEBA consultant as saying of the UAW-automaker VEBA medical cost inflation and investment earning assumptions, “[i]t’s not even close to being realistic, it’s preposterous. . . . Unless they make drastic changes to the way they treat health care, I’d be surprised if the money lasts 20 years.” (omissions in original)).

¹⁹⁰ Howes, *supra* note 187; Poornima Gupta, *UAW to Set Up Strict Controls on VEBA*, REUTERS, Nov. 21, 2007, <http://uk.reuters.com/article/idUKN2064157320071121?sp=true> (“Analysts have said the UAW could wield a big stick as an investor, especially on issues already on its agenda, including health-care costs, corporate governance, executive compensation and trade.”); Frank Bentayou & John Funk, *The State of US Automaking*, CLEVELAND PLAIN DEALER, Sep. 20, 2007, available at:

<http://www.cleveland.com/business/plaindealer/index.ssf?base/business-3/1190278616130100.xml&coll=2>

(Paraphrasing a labor activist’s concern that “[t]he union may feel constrained about any action that could cause stock value to fall—and reduce the worth of the benefit fund.”).

¹⁹¹ Higgins, *supra* note 3.

¹⁹² ERISA §§ 404(a), 409(a), 502(a)(3), 29 U.S.C. §§ 1104(a), 1109(a) 1132(a)(3).

¹⁹³ See, e.g., Prohibited Transaction Exemption 2006-19, 71 Fed. Reg. 70,992 (Dec. 7, 2006) (Kaiser Aluminum); Prohibited Transaction Exemption 93-69, 58 Fed. Reg. 51,105 (Sept. 30, 1993).

¹⁹⁴ Ron Gettelfinger, *Union Pact Protects Health Care Benefits, VEBA’s Help Automakers, But Doesn’t Solve U.S. Problems*, UAW ATISSUE, Dec. 7, 2007, <http://www.uaw.org/atissue/atstory.cfm?atId=222>; see also Gupta, *supra* note 190.

¹⁹⁵ Kosdrosky, *supra* note 51, at A10.

¹⁹⁶ Gettelfinger, *supra* note 194; see also Raymond A.J. Digby, *Politicians Need to Take a Fresh Look at Health Care Funding*, UAW ATISSUE, Oct. 9, 2007, <http://www.uaw.org/atissue/atstory.cfm?atId=218>.

¹⁹⁷ Bentayou, *supra* note 190; Rick Haglund, *Big 3’s Clout Still Needed for Health Care Reform*, GRAND RAPIDS PRESS, Nov. 9, 2007, at C2.

¹⁹⁸ Letter from Paul Schrade, Warren Davis & Jerry Tucker to Ron Gettelfinger & UAW Big 3 Auto Contract Negotiators, reprinted in N.Y. TIMES, Sep. 16, 2007, available at:

<http://www.nytimes.com/2007/09/16/business/17letter.html>.