1785

STATE OF MICHIGAN
EMPLOYMENT RELATIONS COMMISSION
FACT FINDING

In the Matter of:

CITY OF WARREN,

Case No. D97 A-0034

Public Employer

-and-

MICHIGAN AFSCME COUNCIL 25
and AFSCME LOCAL 1250,

Labor Organization

______________________________/

REPORT

Thomas L. Gravelle
Fact Finder

October 16, 1999

Appearing for the City:

Howard L. Shifman, Esq.
Howard L. Shifman, P.C.
370 E. Maple Road
Suite 230
Birmingham, MI 48009

Appearing for the Union:

Michael J. Bommarito, Esq.
Martens, Ice, Geary, Klass,
Legghio, Israel & Gorchow, P.C.
17117 W. Nine Mile Road
Suite 1400
Southfield, MI 48075

FINDINGS AND CONCLUSIONS, RECOMMENDATIONS, AND REASONS

Table of Contents

Table of Contents (con't)

page

INTRODUCTION

This case primarily involves a single question: Should new employees be covered by the present pension plan or should they be covered by a new defined contribution plan?

We held five days of formal hearings primarily on this question. The record measures in feet not inches. It includes hundreds of exhibits comprising thousands of pages, 5 hearing transcripts, and thorough post-hearing briefs.[1]

A fair and full report based on this record and the parties' arguments poses a major analytical challenge. Here is why:

First, the terms of the present pension must be understood.

Second, its cost to the City must be understood.

Third, actuarial concepts must be understood if the cost to the City is to be understood.

Fourth, the proposed defined contribution plan and financial projections under it must be understood.[2]

Fifth, the application of the Michigan Constitution to government pensions must be understood.

---

[1] At 264 pages, the City's brief is longer; however, the City used larger type than the Union.

[2] If the City of Warren were a private company with a non-union work force facing the same question, the analysis could stop here. Even to this point, however, the issues are daunting. The Wall Street Journal has described actuarial discussions of these initial issues as "coma inducing." (U-251).

Sixth, the facts that the City of Warren is politically vigorous and that its current mayor and city council are term-limited must be understood.

Seventh, the fact that the City has a statutory duty to bargain over pensions in negotiating each new collective bargaining agreement must be understood.

Eighth, the factors ordinarily taken into account by fact finders appointed by the Michigan Employment Relations Commission ("MERC") must be understood.

Unless all of these areas are considered, widely different judgments are likely to occur. In other words, the parable of the blind men and the elephant would apply.[3]

Legal aspects of fact finding.

Section 25 of the Labor Mediation Act (LMA) of 1939, 1939 PA 176, as amended, provides for fact finding as follows:

> When in the course of mediation ..., it shall become apparent to the commission that matters in disagreement between the parties might be more readily settled if the facts involved in the disagreement were determined and publicly known, the commission may make written findings with respect to the matters in disagreement. The findings shall not be binding upon the parties but shall be made public.

[3] One said it was a snake, another a tree trunk, etc.

Rule 35 of the Administrative Rules of the Employment Relations Commission, R 423.435, explains the contents of the fact finder report as follows:

> Rule 35. (1) After the close of the hearing, the fact finder shall prepare a fact finding report which shall contain:
>
> (a) A statement of findings of fact and conclusions upon all material issues presented at the hearing.
>
> (b) Recommendations with respect to the issues in dispute.
>
> (c) Reasons and basis for the findings, conclusions and recommendations. However, the parties may waive the requirements of this subdivision and the fact finder may then issue a report containing only items set forth in subdivisions (a) and (b).
>
> (2) The fact finder shall file a copy of his report with the commission and at the same time serve a copy on each of the parties.

MERC has explained that "factfinding is an integral part of the bargaining process" and that ordinarily the bargaining process is to continue for "60 days after the issuance of the factfinder's report." County of Wayne, 1985 MERC Lab Op 244; 1984 MERC Lab Op 1142; *aff'd* 152 Mich App 87 (1986).

The fact finder's report reinstates the bargaining obligation and should be given serious consideration. City of Dearborn, 1972 MERC Lab Op 749.

The reason for fact finding in the present case is that the parties were unable to resolve their disputes by themselves or with the aid of a MERC mediator. As a result, MERC decided on fact finding and I was appointed to serve as the fact finder.[4]

Neither the rules nor the labor acts set forth explicit factors for reviewing the record and making recommendations in fact finding. However, an analogue does exist: The factors set forth in Section 9 of Act 312 PA 1969, which is the Michigan interest arbitration statute for police and fire fighters.

In my report, I rely on these factors where appropriate. They are reasonable and express Michigan public policy in an area similar to public sector fact finding.

Having said this, fact finding differs from Act 312 interest arbitration in two fundamental respects. First, a fact finder can only make recommendations. Second, a fact finder is not limited to the parties' last best offers in making a recommendation.

Comparable Communities.

Before turning to the facts, I wish to address the issue of comparable communities. In 1991, the parties engaged in fact finding before Barry C. Brown. In his report (U-13; C-5), he identified the following communities proposed by Local 1250 as comparable to Warren:

[4] Prior to the formal fact finding hearing, the parties resolved all their differences except their pension disputes -- primarily the proposed defined contribution plan for new employees. These negotiations resulted in 3% annual wage increases for 5 years. The City has estimated that the increases for wages and fringe benefits for the 5 year period will cost the City $8,381,370. (C-30). This would average out to more than $25,000 per employee for the 5 year period.

Ann Arbor
Dearborn
Detroit
Livonia
Roseville
St. Clair Shores
Southfield
Sterling Heights
Troy

In the present case, the City added "those cities with population and SEV within the range of those cities used as comparables" by fact finder Brown, with the goal of obtaining as many communities as possible. (C-Brief 206, 207). The City's additional communities are:

Dearborn Heights
Farmington Hills
Rochester Hills
Royal Oak
Taylor
Westland

In the present case, the Union's comparables include Dearborn Heights and Flint in addition to Brown comparables.[5]

This report does not turn on a precise mathematical calculation of any particular grouping of communities where another grouping would yield a different result. No useful purpose would be served by my pruning the parties' exhibits as they relate to comparable communities. I will weigh; but I will not prune.

---

[5] I note that fact finder Brown rejected Flint, Pontiac and Grand Rapids because they "do not compete in the same labor market and they are not considered comparable to Warren" in other respects.

FINDINGS OF FACT AND CONCLUSIONS

The employer is the City of Warren. It is located in Macomb County and is the third largest city in Michigan. The City of Warren abuts three of Michigan's largest cities: Detroit to the south, and Troy and Sterling Heights to the north.

In 1970, the City's population was 179,000. For the year 2000, it is projected to be about 137,000, where it is projected to stabilize. (C-8-IX). As of the 1990 census, the City's median household income was $35,980. (C-8-XI).

The Union is Local 1250 of Michigan Council 25 of the American Federation of State, County and Municipal Employees Union.

Local 1250 is the largest of several unions representing City employees. It represents around 300 permanent, full-time employees. Local 1250 represents most of the City's civilian, non-supervisory employees. The employees represented by Local 1250 perform an array of City services ranging from accounting to waste water treatment. Overall, the City has about 900 permanent, full-time employees.

The ratio between the City's permanent, full-time employees and retirees is approaching 1:1.

The City's major operating fund is its General Fund.[6]

The General Fund has a balance of about $24 million. Its annual budgeted expenditures are about $80 million. Therefore, its fund balance is about 30% of budgeted expenditures. However, the General Fund has some major unfunded, long-term liabilities relating to employment costs. These are:

General Employees Unfunded Post-Retirement Health Care	$56,600,000
Police & Fire Unfunded Post-Retirement Health Care	$53,000,000
General Employee Unfunded Actuarial Accrued Liability	$36,612,000
Accumulated Sick Leave & Vacation Liability	$10,855,000
	$157,067,000

(C-8-2, 12/31/97 Actuarial Report).

The City payroll for its permanent, full-time civilian employees is about $23 million per year. The City is paying about 16% of this figure for retiree health insurance, and about 24% for required pension contributions. As a result, the City

---

[6] Its 1999-2000 budget (at p. 3) explains:

> The General Fund is the City's major operating fund, providing the majority of services available to our residents. The function of the fund is to record all revenues and expenditures of the City which are not accounted for in other funds. The major activities financed by the General Fund are Police and Fire Protection, City Administration and most Public Services. The primary source of revenues to fund these services is local property taxes generated annually and supplemented by state shared revenues.

is spending 40% of payroll (or over $9 million) per year on retiree health insurance and pensions. Because of medical inflation, the amount for retiree health insurance is volatile and could go higher in the future.

In recent years, the City scored a major success in purchasing the former Army Tank Command for $5.9 million. It then sold a large part of it to General Motors for $30 million, where GM intends to make a $1 billion investment. The City explained that of the $30 million, $10 million will be used for infrastructure, with the balance going to paying down the $157 million in liabilities cited above. To induce GM to make its investment in the property, the City has given it a tax abatement. The City anticipates additional taxes from GM beginning in a few years of about $1 million a year for 12 years. The point is that the new GM complex will be the crown jewel of the City with anticipated effects of increased business and enhanced real estate values. However, it will not itself result in any immediate tax windfall to the City.

The City has had other successes in recent years such as rebidding insurance and some other real estate projects. However, these as well represent either one-time cash infusions or modest tax increases.

Certain events in recent years have contributed to the City's concern about remaining fiscally sound and being able to respond successfully to future contingencies. These events include the following: (a) Proposal A limits increases in taxable property valuation to the lesser of the rate of inflation or 5%, and inflation has been low. (b) The Michigan legislature is considering reducing or eliminating personal property taxes. (c) With a declining population, the City will receive less in State revenue sharing. State revenue sharing is second only to property taxes in providing revenues for the General Fund.

Returning to the General Fund, most of its revenues are from property taxes. Real estate taxes are based on state equalized value (SEV). Among the 15 comparable communities cited by the City, average 1998 SEV per capita is $29,318, whereas the City's 1998 SEV per capita is $26,933. (C-10-IX).

The 1999-2000 General Fund budget provides for about $81 million in expenditures (of which the $23 million for permanent, full-time civilian employees is a part). Municipal government is very labor intensive. The budget breaks down expenditures as follows:

Wages	45.6%
Employee Fringe Benefits	24.8
Other Services and Charges	27.4
Equipment & Capital Improvements	1.4
Operating Supplies	0.8

(Budget, p. 30).

Thus, employee wages and fringe benefits represent 70.4% of the general fund expenditures, with employee fringe benefits being very high (54%) in relation to wages.

The City has offered two exhibits illustrating the total cost to the City of two hypothetical 15 year employees. (C-14-B-1 & 2). The first is a DPW service specialist. His annual wage is $42,598, which is 55.4% of his total cost to the City of $78,833. The major fringe benefit components for this employee are $12,857 for retirement (16.7%) and $10,432 for insurances (13.6%). The second is an account specialist. His annual wage is $37,821, which is 58.8% of his total cost to the City of $64,275. The major fringe benefit components for this employee are $10,739 for retirement (16.7%) and $8,848 for insurances (13.8%).

Local 1250 and the City have not agreed upon a new collective bargaining agreement since 1997.

The fundamental remaining dispute is whether new employees hired after the execution of a new collective bargaining agreement should be covered by the parties' existing pension, which is a defined benefit plan, or by a new defined contribution plan.[7]

I will refer to the parties existing defined <u>benefit</u> plan as the DB plan. DB plans are what we think of as traditional pensions. DB plans spell out the terms of entitlement for a retiree's pension <u>benefit</u>. Under DB plans the employer has the

---

[7] Secondary issues are as follows: The City proposes that overtime be removed from FAC for all active employees under the current pension plan. Local 1250 proposes COLA adjustments for retiree pension benefits and that an additional employee representative be added to the DB plan pension board so that one-half the trustees will be employee representatives.

unconditional duty to pay the pension benefit. In Michigan, this duty has constitutional recognition.

I will refer to the proposed defined contribution plan as the DC plan. With a normal DC plan, the employer guarantees no benefit. Instead, DC plans spell out the terms of contributions to the plan and what can be done by the employee with the contributions.

Where collective bargaining and a city charter are involved (as here), the procedures of the DC plan may be adopted by city charter amendment or ordinance, whereas the contributions for employees would be covered by the collective bargaining agreement.

Both types of plans have pluses and minuses. But for now the point to keep in mind is that with DC plans the employer is at risk only in that it has the contractual duty to make the contributions it has agreed to make. With DB plans the employer is at risk to pay the contributions for the benefits it has agreed to pay.

The City believes if its DC proposals are adopted, the City will save about $10 million over the next 10 years. (C-7, p. 4).

1. THE TERMS OF THE CURRENT DEFINED BENEFIT PLAN.

The terms of the current DB plan (or "City of Warren Employees Retirement System") are set forth in the City of Warren Retirement Ordinance (U-95) as modified by the City's collective bargaining agreement with Local 1250.

Since 1980, the City has been the sole funder of the plan, with no employee contributions from that date. (U-100, p. 13).

A retiree's annual pension is the product of the following formula:

> Years of service x 2.5% x final average compensation (FAC)
>
> -- Pension cannot exceed 75% of FAC
>
> -- Pension reduced slightly at age 62
> (1.1% for first $4200 of FAC, then 2.5% for rest of FAC)

a. <u>**The Multiplier**</u>. The 2.5% (.0250) is called the multiplier. It became effective in 1991. This change applies to all active employees as if there never had been a lower multiplier. Between 1973 and 1991, the multiplier increased by 52%.[8]

No comparable community has a multiplier higher than 2.5% (C-12, p. 1).

Local 1250 members also are covered by Social Security.[9]

---

[8] Section 25-216 of the Ordinance shows the following history of the multiplier: Prior to June 30, 1973, 1.65% (.0165); effective June 30, 1973, 1.8% (.0180); effective July 1, 1974, 1.9% (.0190); effective January 1, 1979, 2% (.0200). In 1984, the multiplier was increased to 2.25% (.0225). Thus, between 1973 and 1991 (and to date) the multiplier increased by .0085. These apparently minuscule changes have increased the multiplier by 52% since 1973 (<u>i.e.</u>, .0085/.0165 = .5151). The change in 1991 from 2.25% (.0225) to 2.5% (.0250) represented an increase in the multiplier of 11% (<u>i.e.</u>, .0025/.0225 = .1111).

[9] <u>Cf</u>. U-87, p. III-8. ("In [DB] plans where employees are covered by Social Security, the average multiplier is just under 2%).

b. **Final Average Compensation**. Final average compensation ("FAC") is defined in the collective bargaining agreement to include the following components:

Base salary
Overtime
Longevity pay
Cost of living
Unused sick pay

The form used by the City in computing FAC includes the following items in addition to those listed above:

Retroactive pay
Out-of-classification pay
Shift premium
Grievance/arbitration award
Pay in lieu of health insurance
Sickness and Accident Insurance
Worker's compensation
Bonus Days
Other (e.g., stand-by pay)

For the unused sick pay component of FAC, the parties have agreed to create 3 tiers, based on first dates of employment:

Date of Hire	Sick Pay in FAC
Before March 7, 1984:	up to 180 days (cap is 225 days x 80%)
Between March 7, 1984 and February 9, 1988:	up to 112 days (cap is 140 days x 80%)
After February 9, 1988:	up to 52 days (cap is 80% of 65 days)[10]

---

[10] Article 23 SICK LEAVE of the parties' collective bargaining agreement explains:

> B. Employees hired prior to March 7, 1984 may accumulate sick leave to a maximum of two hundred twenty-five (225) days. ... Upon retirement, an employee shall be paid eighty percent (80%)

The sick pay component of FAC is without limitation as to the time when the unused and accumulated sick leave actually was earned and accrued. The lump sum payment is allocated to 2 years averaged (see below) rather than to the year in which each unused sick day was earned and accrued.

Most comparable communities do not include sick leave payouts in FAC. (C-12).

c. **2 Year Averaging**. Effective in 1991, the parties agreed to calculate FAC by taking the employee's two years (not necessarily consecutive) yielding the highest compensation, and then dividing it by 2.[11] This change applies to all active employees as if there never had been a lower averaging. Prior

---

> of his accumulated sick leave bank to be included in the employee's final average compensation. ...
>
> C. Effective for all employees hired between March 7, 1984 and February 9, 1988 ... pay out percentages shall be applied to a maximum bank of one hundred forty (140) days. ... Upon retirement, an employee shall be paid eighty percent (80%) of his accumulated sick leave bank (80% of 140 days maximum) to be included in the employee's final average compensation. ...
>
> D. Effective for employees hired after February 9, 1988 ... pay out percentages shall be applied to a maximum bank of sixty-five (65) days. ... Upon retirement, an employee shall be paid eighty percent (80%) of his accumulated sick bank (80% of 65 days maximum) to be included in the employee's final average compensation. ...

[11] The parties' 1991 fact finding report recommended this change despite the fact that the DB plan already provided greater pension benefits than any other comparable community because other City employees had 2 year averaging and "[i]t is time." (U-13, p. 61).

to this time, the parties used the <u>three</u> highest years of FAC and divided it by 3.[1]

There are two primary effects of the shorter averaging period. First, in the ordinary course of annual raises in base pay, the fewer the years to be divided the higher the base pay component of FAC.[2] Second, under the parties' DB plan, the shorter averaging period makes more pronounced the effect of various other components of FAC. For example, when lump sum sick pay of $10,000 is divided by 2, FAC will increase by $5,000; when divided by 3 (as formerly), FAC would increase by $3,333.

No comparable community uses 2-year averaging. Among comparable communities the average "averaging period" is 3.7 years. (C-12, p. 5).

d. <u>**75% Cap**</u>. The source of the 75% benefit cap in the formula is Section 25-228 of the City Ordinance. It states that a member's annual pension benefit shall not exceed "seventy-five (75) percent of the member's final average compensation." The effect of the cap is to provide a partial disincentive to

---

[1] <u>Cf</u>., U-88 (AFSCME report stating, "Benefits under most DB plans are based on the <u>final 3 or 5 years</u> of an employee's earnings (when earnings are typically highest), while DC benefits are based on contributions made over a career, which includes low contributions in early employment years").

[2] <u>Cf</u>., U-87, p. III-8 ("FAC is typically based on the average of the last or highest consecutive salary for three to five years of service, and in a few plans, on the final year's salary. Since salaries ar usually highest in the final years of employment, <u>using fewer years in this calculation results in higher benefits</u>. Some public employees are covered under plans that use career average formulas, which obviously provide lower benefits for most retirees").

continue working after attaining a benefit calculation of 75% of FAC (i.e., 30 years of credited service) for the reason that future pension gains ordinarily will be limited to a fraction of base wage raises.

The benefit caps among comparable communities range from 50% to infinity. (C-12, p. 1). *Standing alone*, 75% is a reasonable benefit cap.

e. Employee contributions. Since 1980 there have been no employee contributions under the parties DB plan.[3]

Most comparable communities have employee contributions ranging from 1.5% to 6.5% with the average employee contribution being 2.7%. (C-12).

f. Other factors. In addition, over the years the age and years of service for full pension entitlement have been reduced. Section 25-216 of the Ordinance explains that prior to 1979 any member who retired before the age of 60 would receive a reduced pension; however:

> Effective January 1, 1979, a member with thirty (30) or more years of credited service may retire at any age with no decrease in benefits because of age. Effective July 1, 1984, a member with twenty-five (25) years of credited service may retire at age fifty (50) with no decrease in benefits because of age.

[3] I note that in 1980 bargaining between Local 1250 and the City, negotiations occurred involving a lower increase in wages for 1980 in return for the employees no longer being required to make contributions to the DB plan. (U-74). Since then, no employee contribution has recurred despite various enhancements of the pension benefit formula.

These changes have been applied to active employees as if there never had been longer periods to achieve full benefits.

For existing employees, the only change the City is proposing is that overtime be removed from FAC. Subject to the overtime issue, under the City's proposal the DB plan will continue to operate as it now does until its obligations to the last covered employee under the DB plan have been completed: At that time the DB plan will cease to exist.[4]

Because Local 1250 has proposed to have future employees covered by the existing DB plan, I now wish to illustrate how it operates.[5]

First, under this DB plan, a promotion in the last years of one's employment can cause one's pension to balloon. In computing FAC all that matters is the compensation paid to the employee in the employee's two highest paid years. If an employee receives a promotion at a significant wage increase covering his last two years of employment before retirement, the fact that he worked at significantly lower wages for his first 28 years of employment is completely irrelevant to the amount of his pension benefit.

Leon LaBrecque is vice president of academics for Educational Technologies, an independent firm which provides education on pre-retirement and defined contribution pension issues

---

[4] **The City's metaphor is that the "dinosaur" would become extinct.**

[5] **In short, all long-term employees do very well under the parties' DB plan pension formula, and some of these employees do amazingly well.**

for large municipalities, small municipalities, and private employers. His testimony was honest and informed. Mr. LaBrecque explained that a promotion in one's last years of employment would constitute "winning the pension lottery."[6]

Second, <u>the parties' DB plan produces widely different pension benefits as a percentage of employee base wages.</u> Between July of 1996 and March of 1999, 27 members of Local 1250 retired with at least 25 years of credited service.[7] (C-26, p. 1). During this period, 8 members of AFSCME 1917 (the supervisory union) also retired.[8] (C-26, p. 2)). Using base salary as a bench mark (a) the Local 1250 retirees received pensions ranging from <u>62% to 142%</u> of base salary; and (b) the higher paid Local 1917 retirees received pensions ranging from <u>64% to 108%</u> of base salary. <u>Id</u>.

These disparities have occurred largely because of two components of FAC: sick pay and overtime. As to the sick pay component of FAC, for the Local 1250 members who retired in recent years with more than 25 years of service, the range of lump sum sick days was 0 days to 224 days, with an average of 101 sick days. (C-26).

[6] Mr. LaBrecque explained that "a person could start in a non-supervisory position and end up in a supervisory position. So ... that's winning the pension lottery, if you'll have it. You work 23 years in one position, and the last two years you end up in a great position and take all your pension based on the last two years." (Tr. I, p. 159). Mr. LaBrecque added, "It would also kick up the liability substantially." (Tr. I, p. 210).

[7] Their average pension as a percentage of final base salary was <u>93%</u>.

[8] Their average pension as a percentage of base salary was <u>87%</u>.

The following two examples are based on actual Local 1250 employees who have retired. I have rounded off the figures.

Employee A. Employee A's base salary at retirement was $40,000. He had 29 years of service. The computation of his FAC included $22,000 in sick pay (subject to 180 day cap) and $28,000 in overtime. By reason of two year averaging, the sick pay increased his FAC to the maximum of 180 days' pay, and the overtime increased his FAC by an additional $14,000. The computation of his FAC also included $13,000 in retroactive pay (some of which apparently fell outside the two year averaging period), $875 in prorated longevity pay, $2,600 in shift premium pay, $4,000 in bonus days pay, $450 in cost of living, and $1,200 in stand by pay. By reason of two year averaging, these additional items increased his FAC by an additional several thousand dollars. When all these sums were added to Employee A's base salary, they yielded a pension to Employee A of $49,000 per year. Employee A's pension is **<u>123%</u>** of his $40,000 base salary. (C-12-D-I).

Employee B. Employee B's base salary at retirement was $39,000. He had 27 years of service. The computation of his FAC included $1,600 in sick pay, and other add-ons. When these sums were added to Employee B's base salary, they yielded a pension to Employee B of $25,000 per year. Employee B's pension is **<u>64%</u>** of his $39,000 base salary. (C-12-D-I).

Cost to City of One Hour of Overtime. In order to simplify understanding of the cost of the DB plan, I think that a simple example may be helpful: one hour of overtime. To calculate the total discounted present value of the cost to the City of one hour of overtime (time and one-half and increased pension benefit), I offer the following example: In his last two years of employment, an employee is paid $20 per hour. He works one hour of overtime at $30 (time and a half) near the end of that period, and retires with 30 years of credited service and a post-retirement life expectancy of 25 years. The discounted present value of the cost to the City of this one hour of overtime is about $166.[9]

Cost to City of One Hour of Lump Sum Sick Pay. Using the same example as above, the total discounted present value of the cost to the City of one hour of a sick pay payout and inclusion in the employee's FAC at the employee's retirement would be $110. For one day (8 hours), it would be $880.

[9] Here is the calculation: $30/2years = $15. $15 x .75 (i.e., 30 years x 2.5%) = $11.25. Therefore, the employee's annual pension is increased by $11.25. He will live for 25 years so he will receive an additional $281.25 in pension benefits. The present value of the $281.25 (paid in equal annual increments over 25 years) discounted by 7.5% per year is about $136. In this illustration, the total cost of one hour of overtime for an employee with a regular hourly rate of $20.00 is $166.00 ($30 at time and one-half plus $136 as discounted present value of cost of increased pension benefit).

2. COST OF THE CURRENT DEFINED BENEFIT PLAN.

The cost of the current DB plan has two components in its (a) annual contribution requirement. These are (b) normal cost, and (c) unfunded actuarial accrued liability.[10]

The most recent actuarial valuation report is for the fiscal year ending December 31, 1997. (C-12-E). It states:

CONTRIBUTIONS NEEDED TO FINANCE BENEFITS OF THE RETIREMENT SYSTEM FOR THE FISCAL YEAR BEGINNING JANUARY 1, 1999

Contributions for	Level Percents of Total Payroll
Normal Cost	
Service pensions	14.16%
Disability pensions	0.70
Pre-retirement survivor pensions	1.13
Termination benefits	
Deferred service pensions	0.51
Refunds of member contributions	0.00
Total Normal Cost	**16.50**
Unfunded Actuarial Accrued Liability	
Retired members and beneficiaries	0.00
Active and vested terminated members	8.20
Total Unfunded Actuarial Accrued Liability	**8.20**
Total Contribution Requirement	24.70
Member portion	0.00
City portion	**24.70%**[11]

[10] The meaning of these terms is explained in section 3 below, ACTUARIAL CONCEPTS.

[11] The 24.70% of payroll cost is not limited to 24.70% of base salary. Rather, payroll includes all paid compensation, including vacations, holidays and overtime. The entire 24.70% is paid by the City, with no employee contribution.

Unfunded actuarial accrued liability was financed as a level percent of member payroll over a period of 23 years. A 30 year period, commencing with the June 30, 1990 valuation, was adopted by the Board of Trustees at its meeting on April 15, 1992.

For any period of time, the percent-of-payroll contribution rate needs to be converted to dollar amounts. We recommend one of the following procedures.

(1) Contribute dollar amounts at the end of each payroll period ....

(2) <u>Contribute the following annual amount: $5,894,510.</u>

a. Annual contribution requirement. For 1999, the City has been required to pay $5.9 million to the DB plan. This is based on its 24.70% annual contribution requirement for 1999. 24.70% is less than the previous contribution rate of 26.50%. The reason for the reduction appears to be based on the bull market for stocks. The actuarial report explains:

> The net actual experience of the Retirement System during the 18 months ended December 31, 1997 was more favorable than expected based on long-term assumptions. <u>Investment income was the primary source of favorable experience</u>, which was partially offset by:
>
> i) more retirements than assumed,
>
> ii) fewer active member terminations than assumed, and
>
> iii) salary increases at a rate greater than assumed.[12]

[12] **Another offset would be that caused by a new standard of the Governmental Accounting Standards Board (GASB) which provides that accrued liability computed for funding purposes is to be used instead of the previous GASB standard. By reason of this change accrued liability increased.**

> <u>The decrease in the City's computed contribution rate reflects the favorable experience.</u>

(C-12, p. A-6).

In comparison with comparable communities, the City's **24.70%** contribution requirement is very high. The most recent actuarial reports for the following cities and their employer contribution requirements are:

City	**City Contribution Rate**
Ann Arbor	2.90%
Dearborn	9.06
Farmington Hills	6.23
Flint	34.29
Livonia	1.48
Royal Oak	0.00
St. Clair Shores	12.10
Southfield	0.00
Sterling Heights	0.00
Troy	0.00
Average:	**6.06%**
Average (without Flint)[13]	**3.53%**

It is primarily the high cost of maintaining the present DB plan that has caused the City to propose a DC plan for new employees.[14]

---

[13] The City has insisted (with good reason) throughout these proceedings that it does not regard Flint as a model it wishes to emulate.

[14] In its Brief at p. 195 the City explains, "We would certainly agree that if we were Southfield or Royal Oak and paying no money into our pension system, we had the normal level of benefits that all these other communities have with no unfunded liabilities and pension costs which may virtually be non-existent due to the overfunding in those systems, that we wouldn't be in these proceedings today."

As mentioned above, the cost of the current DB plan has two components: normal cost, and unfunded actuarial accrued liability.

b. Normal Cost. The following summary shows the cost of service pensions and total normal cost,[15] along with employee contributions, and the net employer contribution for the total normal cost of a pension:

City	Service Pension	Normal Cost	Employee Contribution	Net Employer Contribution
Ann Arbor	12.29%	14.88%	4.68%	10.20%
Dearborn	12.73	13.96	0.00	13.96
Farmington Hills	14.15	15.17	3.93	11.24
Flint	17.86	19.74	3.78	15.96
Livonia	13.16	16.01	3.15	12.86
Royal Oak	12.37	16.53	3.99	12.54
St. Clair Shores	12.94	15.29	1.11	14.18
Southfield	8.24	10.43	3.50	6.93
Sterling Heights	12.80	14.69	5.00	9.69
Troy	10.27	13.65	1.08	12.57
Average:	12.68%	15.03%	**3.02%**	**12.01%**
Warren:	14.16%	16.50%	**0.00%**	**16.50%**

In comparison with comparable communities, the City's contribution requirement for the normal cost of the DB plan is very high. As a percentage of payroll, the City's contribution requirement for service pensions is **12%** higher than the average of the above communities. The City's net contribution requirement for total normal cost of its DB plan is **37%** higher than the

[15] **Total normal cost = combined cost of (a) service pensions + (b) disability pensions + (c) pre-retirement survivor pensions + (d) termination benefits.**

average of the above communities. In addition, because Local 1250 members receive compensation significantly in excess of the average of comparable communities (which compensation is reflected in FAC) the City's contribution requirement for the normal cost of the DB plan in absolute dollars is to that extent higher than the above percentages.

The major reasons for Warren's relatively high contribution rate for the normal cost of the DB plan (there being no evidence that Warren retirees live longer than other retirees) are a generous formula for computing retirement benefits, and no employee contributions.

c. **Unfunded Actuarial Accrued Liability.** This part of a DB plan contribution requirement is discussed in section 3 below.

3. ACTUARIAL CONCEPTS.

The actuarial report contains two pages of definitions of technical terms. (C-12-E ,pp. C-7, C-8). For purposes of this Report, the following definitions are crucial to understanding the issues:

> **EXPERIENCE GAIN (LOSS).** The difference between actual actuarial costs and assumed actuarial costs -- during the period between two valuation dates.
>
> **NORMAL COST.** The actuarial cost allocated to the current year by the actuarial cost method. Sometimes referred to as "current service cost."

ACTUARIAL ACCRUED LIABILITY. The difference between the actuarial present value of future benefit payments and the actuarial present value of future normal costs. Also referred to as "accrued liability" or "past service liability."

UNFUNDED ACTUARIAL ACCRUED LIABILITIES. The difference between actuarial accrued liabilities and the actuarial value of system assets. Sometimes referred to an "unfunded past service liability," "unfunded accrued liability" or "unfunded supplemental present value."

Most retirement systems have unfunded actuarial accrued liabilities. They arise each time new benefits are added and each time an experience loss is realized.

The existence of unfunded actuarial accrued liabilities is not in itself bad, any more than a mortgage on a house is bad. Unfunded actuarial accrued liabilities do not represent a debt that is payable today. <u>What is important is the ability to control the amount of unfunded actuarial accrued liabilities</u> and the trend in their amount (after due allowance for devaluation of the dollar).

Unfunded actuarial accrued liability will increase when any component of the retirement benefit formula is increased (without an offsetting employee contribution). The increase can be much greater than an intelligent person who is not an actuary might suspect. The reason is that the increase (unless limited to prospective application for employees hired after the change)[16] will apply to all current employees no matter whether they have worked 1 day or 30 years at the time of the increase:

[16] This would be an unlikely occurrence in collective bargaining where, for obvious reasons, the financial interests of the existing members of the bargaining unit come first.

> Q [By Mr. Shifman] Under a defined benefit plan, what happens if I raise the benefits for those individuals after they've been working for me 10 or 20 years?
>
> A [By City expert LaBrecque] If you raise the benefit level on a basis that takes into account prior service, then you increase that prior service liability.
>
> Q Is that how --
>
> A (Interposing) And you increase the cost.
>
> Q Is that how you end up with unfunded liabilities?
>
> A Yes. And it's also how you increase the cost of the plan.

(Tr. I, pp. 120-121).

The DB plan's "unfunded actuarial accrued liability" represents 8.20% of payroll to be paid annually by the City for the next 23 years (unless any pension formula increase is added in the next 23 years without an offsetting employee contribution) at which time it will be fully paid off.[17] The reason for most (if not all) of this liability is that in the early 1990's the parties increased their multiplier by 11% (from 2.25% to 2.50%) and reduced the averaging period from 3 years to 2 years without any employee contribution being added to pay for these increases.

---

[17] Actuary Sonnenschein has explained that "you only have to pay off your unfunded accrued liability once." (U-101, p. A-46).

The DB plan's current "normal cost" represents 16.50% of payroll to be paid by the City for the life of the DB plan (subject to any adjustments for changes in assumptions, valuations, and pension formula increases).

At a pension board meeting two years ago, Actuary Gerry Sonnenschein was questioned about the effect on the contribution level to the DB plan if the number of active employees under it was reduced by reason of employees being in a DC plan. He explained that the effect would be to increase as a percentage of payroll the City's unfunded actuarial accrued liability because there would be fewer employees under the DB plan. He added, however, that the actual dollar payments made by the City for the actuarial liability would be about the same, and that the way the City would save money is by contributing a lower percentage to a DC plan than the "normal cost" of the DB plan.[18]

---

[18] Actuary Sonnenschein explained:

> ... [W]hen I do a valuation for the closed retirement plan at Oakland County, I work with the people who remain in the [County's DB] plan, so that the unfunded liabilities have to be financed over the payroll of those people just as a contribution rate. And ... the percentage would be higher.
>
> But, in the long run, even though the percentage is higher because it's being expressed as a portion of smaller payroll, it's still a similar dollar amount to what ... the City would have had to pay, anyway, to pay off that specific amount of unfunded liability. That part of it doesn't go away.
>
> ... The City will save money if it contributes less to the defined contribution plan than the normal cost of the defined benefit plan; because, for every new person into this plan, the City basically needs to pay a normal cost. I mean, it doesn't really have to pay a new liability, there's no unfunded liability for a new person. So that that's where the savings or non-savings will tend to occur.
>
> ...

4. THE PROPOSED DEFINED CONTRIBUTION PLAN

The City has adopted an ordinance creating the procedural framework for a new defined contribution plan (the ICMA prototype papers). The interplay of this DC plan ordinance and the parties' collective bargaining would be as follows:

> The home rule cities act and PERA can be easily reconciled by reading the home rule cities act to empower a city to set up the procedures for its pension plan in the charter and to leave the substantive terms of the plan to collective negotiation.[19]

The City proposes that the DC plan apply to all future employees and be funded by a 9% City contribution and a 3% employee contribution.[20] As to the latter, the City points out that among comparable communities a 3% employee pension contribution is about average. Further, among the numerical minority of communities with DC plans, the proposed funding formula for the DC plan is a reasonable one. (C-Brief-8). Examples follow:

> ... [Y]ou only have to pay off your unfunded accrued liability once. And whether the people are here or in a defined contribution plan, you have to pay it off. That's why the [cost] comparison really does come down to what goes into the defined contribution plan versus what's the normal cost of the benefits being earned under this [DB] plan. (U-101, pp. 44-45).

[19] <u>Detroit Police Officers' Association</u> v. <u>City of Detroit</u>, 391 Mich 44, 67-68 (1974).

[20] The 3% employee contribution would be made from pre-tax income. As a result, an employee in a 28% income tax bracket would be out of pocket only 1.8%. (Tr. I, 185-186).

Employer	Employer Contribution	Employee Contribution
State of Michigan	7.00%	3.00%
Oakland County	5.00%	3.00%
Washtenaw County	7.50%	7.50%
Livonia	7.00%	3.10%
Troy	11.00%	5.00%
Ferndale	9.00%	3.00%
Rochester Hills	10.00%	1.00%

The City estimates that its proposal would save the City about $10 million over 10 years.

The parties have prepared a host of financial projections to show the effect of the City's proposed DC plan.

City Expert LaBrecque explained that for pension investments it is reasonable to assume an annual rate of return of 7 1/2% or 8% based on the prudent allocation of assets into 40% bonds (guaranteed, but lower return) and 60% non-guaranteed securities.

One City example is of a hypothetical employee whose starting salary is $25,000, who receives annual raises of 3%, and who retires after 30 years of service at a salary of $59,798. (C-13-B). Assuming an 8% rate of return, at retirement the employee's DC account would be worth $521,956. If this principal continued to earn 8% interest, after one year the employee could begin receiving interest of $3,480 per month (or $41,756 per year) without touching the principal. The interest alone would equal 70% of his final salary. If the employee factored in the principal of $521,956, his monthly and yearly benefits would be considerably higher. At death, he would devise to his heirs the balance of his DC principal.

Another City hypothetical is the same, except that it posits annual raises of 2.5% and a salary at retirement of $51,800. Under this hypothetical, at retirement the employee's DC account would be worth $493,099. After one year of retirement the employee could begin receiving interest of $3,287 per month (or $39,448 per year). This benefit would equal 76% of his salary.

These hypotheticals yield a substantial pension benefit.

Local 1250 points out that (a) 7.5% is the actuarially asssumed rate of return in the parties' DB plan and a more conservative (therefore preferable) interest rate than 8%; and (b) 25% of the DC account should be factored out because it represents the employee's contribution (which is not required under the parties' DB plan).

Local 1250 has an exhibit which corresponds to the second hypothetical (i.e., 30 year employee starts out at $25,000 per year and receives annual raises of 2.5%) (U-119). In this exhibit the employee ends up with a final salary of $51,160.[21] Local 1250 assumes a 7.5% annual rate of return. Under this hypothetical, at retirement the employee's DC account is worth $414,422. Local 1250 then works out a series of comparisons of how this employee would fare under the present DB plan and the

---

[21] **I note that the City's final salary of $51,800 is slightly higher. I don't have time to locate the source of this discrepancy. For me, it will remain an unsolved mystery.**

proposed DC plan. It doing so, Local 1250 looks only to the City's 9% contribution (because the 3% employee contribution is his own money). (U-120-123). The results show that the employee, if he lives a long time, would fare far better under the current DB plan. Local 1250 calculates the total payout as more than twice as much under the DB plan as under the proposed DC plan. (U-122).

In comparing the proposed DC plan to the existing DB plan, the proposed DC plan favors employees who (a) leave the City's employment well in advance of normal retirement (i.e., portability), (b) make investments with a high return,[22] or (c) die prematurely.[23] For long-lived, career employees the existing DB plan (probably the best in the State for employees) would be more lucrative.

With any DC plan, there is a risk of poor investments by employees. Should this occur, the City can expect employees to

---

[22] **If anyone had the gift of predicting exactly how the stock market would perform the next day, that person would become richer than the Sultan of Brunei. However, there are trends. Mr. LaBrecque explained that between 1802 and 1998, the stock market had an average annual increase of 9.3%; and between 1926 and 1998 of 11%. He added that by prudently putting 40% in bonds and 60% in stocks the average annual return would be 9.33%. (Tr. I, 141). (I would add that many stocks pay dividends which in a pension account are converted into additional stock. This is part of the "miracle of compounding." I'm not sure to what extent this factor was taken into account by Mr. LaBrecque.)**

[23] **Half the human race does so. Actuary Jerry Sonnenschein explained, "Life expectancies are just averages, which means that about half of the people are going to die before that average age and about half of the people are going to outlive it." (U-101, p. 36).**

work longer than they would have under the DB plan and also to apply pressure in future negotiations for relief.[24]

5. THE MICHIGAN CONSTITUTION AND GOVERNMENT PENSIONS.

The Michigan Constitution is a bedrock fact in understanding any Michigan public sector DB plan. Indeed, it is even more basic to the parties' DB plan than its express terms.[25]

The City of Warren is a political subdivision of the State of Michigan.

Article 9, Section 24 of the Michigan Constitution of 1963 states:

> Sec. 24. **Public pension plans and retirement systems, obligation**
>
> Sec. 24. The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.
>
> **Financial benefits, annual funding**
>
> Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.

---

[24] Cf., U-88, p. 5 (AFSCME analysis stating that "employees in DC plans who have not earned sufficient funds on which to live out the remainder of their lives may be forced to stay employed longer at a higher salary, preventing upward movement by young, lower paid workers. Finally, if DC plans produce inadequate incomes, ... future employees may pressure legislatures to reestablish DB plans, creating large past service liabilities that will need to be funded").

[25] It is also part of "the lawful authority of the employer," an Act 312 factor often used by fact finders.

The official comment of the Constitutional Convention is as follows:

Convention Comment

> This is a new section which requires that accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions be a contractual obligation which cannot be diminished or impaired by the action of its officials or governing body. It provides further protection for those governed by such pension and retirement plans by requiring that benefits arising on account of service rendered in each year be funded during that year. Such funding shall not be used for financing unfunded accrued liabilities.
>
> This section is an attempt to rectify, in part, policies which have permitted sizeable deficiencies to pile up in retirement systems in this state. Under this section, accruing liability in each fiscal year must be funded during that year, thus keeping any of these systems from getting farther behind than they are now.

Article 9, Section 24 has two fundamental purposes. These purposes are to assure that pensions granted by public officials are (a) contractual commitments,[26] and (b) actuarially sound.[27]

---

[26] Constitutionality, 1972 PA 258, 389 Mich 659, 662-663 (1973)(advisory opinion) explains:

> It had long been the general rule that pensions granted by public authorities were not contractual obligations but gratuitous allowances which could be revoked at will by the authority because the pensioner was not deemed to have had any vested right in their continuation. [Citing cases where pension benefits decreased or eliminated after retirees had begun to receive them.]
>
> ...
>
> That it was the intention of the framers of the constitution to obviate this harsh rule is apparent from the minutes of the convention.

a. Contractual commitments. Major questions are whether any factor in the pension benefit formula ever can be reduced unilaterally for existing employees, and whether a contribution from existing employees ever can be begun or increased unilaterally without a compensating increase in pension benefits.

The Michigan Court of Appeals has interpreted "accrued financial benefits" to mean the granting of a pension right.[28] This suggests that a Michigan public employer unilaterally can reduce an accrued component of DB pension formula (at least absent an offsetting formula improvement) for future employees only.

The Court of Appeals also has decided that a Michigan public employer may neither delay eligibility for pension benefits "as to work already performed," nor "unilaterally impose" a fee as a condition to retaining eligibility as to employees' "previously earned and accrued pension benefits."[29]

In this case, the involved unions disagreed with the two diminutions "unilaterally imposed" by the City. Thus, it is possible that if a union were to agree to a diminution, that

---

[27] Jurva v Attorney General, 419 Mich 209, 225 (1984) explains:

> The overriding concern of the delegates to the Constitutional Convention was the establishment and maintenance of the actuarial soundness of the state's pension systems ... .

[28] Seitz v Retirement System, 189 Mich App 445, 456 (1991) ("the state may not reduce the pension benefit of any state employee or official, or local employee or official, once a pension right has been granted").

[29] APTE v Detroit, 154 Mich App 440, 446, 447 (1986).

might not give rise to a constitutional challenge by individuals based on their "previously earned and accrued pension benefits."

The point is that where a DB plan contains too many "bells and whistles," a bell or whistle can be reduced or removed unilaterally, without raising any doubt under Article 9, Section 24, for new employees only.

There is no published appellate law in Michigan on the application of Article 9, Section 24 to DC plans. It is possible that courts will reason (at least if the collective bargaining agreement is viewed as the DC document containing its substantive financial terms, e.g., rates of contribution and definition of "earnings" or "compensation") that "accrued financial benefits" would be limited to funds in an employee's DC account together with an employer's obligation under the **current** collective bargaining agreement to make contributions to it. If so, this would give the parties great flexibility in addressing future contingencies (e.g., vagaries of stock market or poor employee investments.)

(b) Actuarial soundness. Article 9, Section 24 requires proper funding of DB plans payable in the current year as well as unfunded accrued liabilities.[30]

---

[30] **Shelby Township Police and Fire Retirement Board v Charter Township of Shelby, 438 Mich 247 (1991).**

This funding obligation, in turn, must depend on actuarial directives. Actuaries provide the best available probability analysis. If you second guess an actuary (and you are not yourself an actuary), you might as well be playing a game of chance.

Therefore, if a pension board were to "re-set the clock" on pension investments in order to increase their value in a way at odds with an actuary's lower valuation, without the approval of the actuary, a question would arise as to whether the pension board thereby violated Article 9, Section 24.[31]

6. THE CITY OF WARREN AND THE POLITICAL PROCESS

Both Leon LaBrecque, the City's expert, and Gerald Sonnenschein, the actuary of the City of Warren Employees's Retirement System, have remarked on the politics of public sector labor relations. Mr. LaBrecque said that "with any political situation, the word 'never' never comes into play. When somebody says, we're going to do this forever, that means until the next people are elected." (Tr. I, p. 194). Mr. Sonnenschein earlier stated that "everybody says when a choice is made it's irrevocable. You know how long irrevocable works, until there's enough pressure for things to change." (U-101, p. 41).

[31] **I am unable to agree with Local 1250 that I should find the DB plan highly funded (and therefore entitled to a reduced "normal cost") in the absence of an official actuarial report and recommendation to that effect which the Pension Board then has voted to adopt.**

The political history of the City of Warren as to the compensation of its employees, elected officials and appointed officials reveals a certain lack of restraint, and finger-pointing.

In 1997, two of the five trustees of the City of Warren Employees' Retirement System were Mark Steenbergh, mayor of the City of Warren, and William O'Brian, then president of Local 1250.

At the August 28, 1997 meeting, trustees Steenbergh and O'Brian made the following remarks:

> TRUSTEE O'BRIAN: ... I belong to [AFSCME Local] 1250, and the 1250 representative is here, and we didn't get those benefit changes, all we did was keep up with the [AFSCME Local] 1917 union, which is the supervisor's union, which also covers elected and appointed officials. The 1917 union covers their benefits in the Pension Plan. And <u>1250 never initiated any increase in pension benefits, all we did was try to keep up.</u>
>
> ...
>
> ... Everybody that is an elected official and an appointed official today, <u>if you look down the road for 24 years, there will be new elected officials</u>, and those elected officials will then be in charge, <u>and they're not going to sit back and take only 10 percent</u>. They're going to be in charge, and <u>they're going to change it again, they're going to cost the City more money</u>. ...
>
> TRUSTEE STEENBERGH: ... [Speaking of the 1991 increase of the multiplier to 2.5% and two year averaging of FAC] <u>[N]either the elected officials</u> that made that decision and inked that deal with the unions, <u>nor the union representatives, nor anybody in the plan said,</u> Well, go back retrospectively to the date that I hired here and let me beef that whole system up, and <u>let me pay back</u>

> something, some formula to meet what the new demand is going to be by our actions, that new multiplier and that new FAC formula. Nobody did that retrospectively, right?
>
> ... And so, now we're at the point of 26.1 percent of what we pay out annually in payroll as our contribution annually to this System to make it whole to meet its unfunded liability. Okay?
>
> ...
>
> TRUSTEE O'BRIAN: ... The Council has a vested interest, the people that are going to get the most out of this plan have a vested interest for the defined contribution plan.
>
> TRUSTEE STEENBERGH ... [Regarding] this 2.5 and this two-year average. Nobody said, Well, geez, I worked here for 18 years, don't you think I should go back and pay a little more over the course of those 18 years to get to that point?
>
> ...
>
> [T]his is the "maximoso" plan that I've ever reviewed. I've never seen a better retirement formula in my existence in government than this formula.
>
> TRUSTEE O'BRIAN: Well, Mark, I don't want to really belabor it, either, but, you know, you inherited something that some other people made, okay? As I pointed out, I've been president of 1250, and we never initiated pension improvements. They've always come by 1917, who got the same benefits as the elected officials, okay, or appointed officials.

(U-100, pp. 14, 29, 33, 35, 50, 51).

Gerald Sonnenschein, the DB plan's actuary, was invited to an informational meeting to answer questions about the plan. At the September 17, 1997 meeting, the following remarks were made:

TRUSTEE STEENBERGH [refers to the generous components of the existing plan]

TRUSTEE O'BRIAN: That was all done by appointed and elected officials. They wanted it, and that's the way it got here. Not these particular ones [current elected and appointed officials], I'm not blaming these, but [past] appointed and elected officials raised the rates, they raised the contributions, they raised everything.

MR. SONNENSCHEIN: ... These certainly do seem to be generous benefits.

I work with about, in the area of 30 municipal plans in this state, and these are generous -- very definitely generous benefits.

... [T]he union's job is to try to get more benefits. It's management's job to say no when they should be saying no. And, unfortunately, if you don't say no on small steps, then some plans come up against it saying, This is just too expensive, we have to make a radical change.

Now, maybe I'm back in my ivory tower. I think if in those communities they had enough power and strength to say, We're going to close this plan entirely and set up another plan, then, well, why didn't they have enough strength along the way to say, The benefits are good enough where they are.

TRUSTEE O'BRIAN: Because politicians only stay so long, and then they move on and leave a big bag for the next group.

TRUSTEE STEENBERGH: ... [N]obody, including an elected official who would retire in that period under the new formula, ever said, well, go back to my first year here and calculate some form of contribution that I can give to help sustain what I'm about to get.

(U-101, pp. 49-51).

A year after these two meetings, the City reached an agreement with UAW Local 412, Unit 59 for its bargaining unit to have a mandatory DC plan for its new employees. In a City press release dated October 14, 1998, the City stated that "Warren Mayor Mark Steenbergh and the UAW will announce a partnership that will protect the long-term viability of the City for both its employees and taxpayers." (C-38). In an accompanying release dated October 15, 1998, UAW regional director Nate Gooden is quoted as saying that "the contract is a good deal that protects the jobs of his union members. 'We know what will happen if we don't reform these pensions,' Gooden said. 'We must protect the long-term interests of our members.'" Id. Subsequently, UAW Local 412, Unit 35 (5 assistant city attorneys) also agreed to a mandatory DC plan for its new employees.

These changes appear to have set off a firestorm of protest from the two AFSCME bargaining units, Local 1250 and Local 1917.

The Macomb Daily reports the following (U-83; C-41) about the council meeting at which the tentative agreement with UAW Unit 35 was up for a vote:

> As part of a tentative agreement, the attorneys union said it would only accept the contract if elected officials and nonunion political appointees accepted the same deal.
>
> In a heated meeting Tuesday night attended by leaders of various city unions and employees, council unanimously approved the contract with the UAW unit. At one point, a top UAW official threatened to file an unfair labor practice complaint against the council if it allowed representatives of other bargaining units to comment on the agreement at the meeting.

> In accepting the challenge of the lawyers group, council voted 8-1 to link the pay raises and benefits of appointees -- and the perks of elected officials -- to a UAW agreement for the first time.
>
> "That was nothing but smoke and mirrors to enhance their benefits right before the election," said Rick Traub, president of American Federation of State, County and Municipal Employees Local 1250, Warren's largest union with some 310 members.

Another political aspect of the City of Warren's labor relations is the following: Prior to the most recent election, Local 1250 sent to candidates a questionnaire pertaining to wages and other benefits and conditions affecting Local 1250 members. (U-37-42). Some candidates who were elected wrote "yes" to the following question:

> 5. Do you believe that employees in the Local 1250 bargaining unit should have the same fringe benefits as the Firefighters and Police Officers?.[32]

The fire fighter and police collective bargaining agreements do not have a DC plan for new employees. Therefore, Local 1250 insists that the Mayor and City Counsel should be barred from seeking to implement a mandatory DC plan for future employees represented by Local 1250.

---

[32] **I note that according to Gabriel, Roeder's <u>1997 SURVEY OF MICHIGAN PUBLIC EMPLOYEE RETIREMENT SYSTEMS</u> 178, the City's police and fire fighters have no social security coverage. The City's civilian employees are covered by social security.**

7. DUTY TO BARGAIN OVER PENSION ISSUES.

Because of the long view into the future which is required to make findings concerning pensions, the Public Employment Relations Act (like the Michigan Constitution and the political climate of the City) is as relevant to future behavior as projected returns on investments.[33]

Section 10(e) of PERA, MCLA 423.210(e), requires the City to bargain over terms and conditions of employment. Changes in a city's retirement plan are mandatory subjects of bargaining.[34]

Under PERA, no matter what type of pension plan is implemented for new employees, Local 1250 (and also the City) will have the right to revisit pension issues in their future negotiations.

The point is that if the wrong resolution is reached now, negotiations in the future could be troublesome.

---

[33] PERA is also part of "the lawful authority of the employer," an Act 312 factor often used by fact finders.

[34] <u>Detroit Police Officers' Association</u> v. <u>City of Detroit</u>, 391 Mich 44, 63 (1974). As to the relationship between a city ordinance on pensions and collective bargaining, the Court explained at pp. 67-68:

> The home rule cities act and PERA can be easily reconciled by reading the home rule cities act to empower a city to set up the procedures for its pension plan in the charter and to leave the substantive terms of the plan to collective negotiation.

8. ACT 312 FACTORS.

Act 312 PA 1969 is the Michigan interest arbitration statute for police and fire fighters. Section 9 states several factors to be considered by an Act 312 arbitrator:

> ... [T]he arbitration panel shall base its findings, opinions and order on the following factors, as applicable:
>
> (a) The lawful authority of the employer.
>
> (b) Stipulations of the parties.
>
> (c) The interest and welfare of the public and the financial ability of the unit of government to meet those costs.
>
> (d) Comparison of the wages, hours and conditions of employment of the employees involved in the arbitration proceeding with the wages, hours and conditions of employment of other employees performing similar services and with other employees generally:
>
> (i) In public employment in comparable communities.
>
> (ii) In private employment in comparable communities.
>
> (e) The average consumer prices for goods and services, commonly known as the cost of living.
>
> (f) The overall compensation presently received by the employees, including direct wage compensation, vacations, holidays and other excused time, insurance and pensions, medical and hospitalization benefits, the continuity and stability of employment, and all other benefits received.

> (g) Changes in any of the foregoing circumstances during the pendency of the arbitration proceedings.
>
> (h) Such other factors, not confined to the foregoing, which are normally or traditionally taken in consideration in the determination of wages, hours and conditions of employment through voluntary collective bargaining, mediation, fact-finding, arbitration or otherwise between the parties, in the public service or in private employment.

Fact finders often consider these factors in making their reports, and the parties have relied on them. Therefore, I will address them.

(a) "The lawful authority of the employer" is affected by Article 9, Section 24 of the Michigan Constitution and its duty to bargain under PERA. These matters have been reviewed above.

(b) "Stipulations of the parties" have resolved their outstanding issues except for the pension issues.

(c) "The interest and welfare of the public" is to receive sound and timely public services. As to "the financial ability" of the City to meet the costs of these services, I find:

-- The City pays for the services of its employees from its General Fund.

-- The City pays 40% of its regular, full-time, civilian payroll for retiree health insurance and retiree pensions. This large percentage increases the cost to the City of each employee. Therefore, it limits the discretion of the City in hiring new employees and incurring other expenses.

-- The high cost per employee would place certain employees (e.g., sanitation and janitorial workers) at special risk if the City were to face a budgetary squeeze. Most comparable communities already have privatized their sanitation services, and about one-half their janitorial services. Communities have done so to save money.

-- The City is not on the brink of insolvency and has a good bond rating. However, the City is not a cornucopia and needs to avoid taking on more obligations than it can reasonably pay for without sacrificing its ability to address new contingencies.

-- The "normal cost" of the current DB plan is 16.50% of payroll, and is paid for entirely by the City. Under the proposed DC plan, the City would contribute 9% of wages for new employees. The City estimates that this change would save it $10 million of over the next 10 years, and would allow it to plan for the future more effectively.

(d) As to compensation in general, the average compensation among comparable communities is far lower than that paid by the City. Two illustrations follow:[35]

15 year account specialist:

Average: $28,418
Warren: $37,356
(31% higher than the average.)

15 year auto mechanic specialist:

Average: $35,490
Warren: $43,552
(23% higher than the average.)

As to pensions, most comparable communities have DB plans for all of their employees.[36] This is also true of most communities in Michigan, with notable exceptions being the State of Michigan (the largest public employer), Livonia, Troy, and Oakland County. Within the City of Warren, two UAW locals have agreed to a DC plan for new employees. AFSCME Locals 1250 and

---

[35] C-11-XXXI & XXXII are comparisons (based on 1996-1997 base salary, longevity pay, COLA, and other payments, minus employee pension contributions) of two City employees and equivalent employees from 15 comparable communities.

[36] For many comparable communities, it is now less expensive to fund their existing DB plans than it would be to pay the City's proposed 9% contribution for its new employees.

1917, and the police and firefighter unions,[37] have not agreed to DC plans for new employees.

(e) Employees of the City receive a "cost of living" allowance, and their wage gains over the years have been favorable in comparison with increases in the consumer price index.

(f) "The overall compensation presently received by the employees" of the City is extremely favorable in comparison with the overall compensation received by employees of comparable communities. The "continuity and stability of employment" for these employees would be enhanced by the adoption of the new DC plan: By saving the City money and making planning more predictable, it would lessen the possibility of a budgetary squeeze in which some employees (e.g., sanitation and janitorial workers) would be at special risk of job loss.

(g) There have been no "changes in any of the foregoing circumstances" during this proceeding other than the parties agreeing to various terms for their 1997-2002 agreement.[38]

---

[37] Unlike the City's civilian employees, its police and fire fighters do not have social security coverage. Social security is a significant component of replacement income for retirees, and its presence (or absence) bears on the adequacy of a pension benefit to provide sufficient replacement income in retirement.

[38] The City has estimated that the agreed upon increases for wages and fringe benefits for the 5 year period will cost the City $8,381,370. (C-30). This would average out to more than $25,000 per employee for the 5 year period.

(h) An "other factor" taken into account in reviewing the issue of whether future employees should be covered by a DC plan or a DB plan is how the two plans would work. This has been discussed at length above.

RECOMMENDATIONS

1. If the City and Local 1250 were to stipulate that I must make an either/or recommendation for future employees between the present DB plan (without any changes for future employees) and the proposed DC plan for future employees, I would recommend the DC plan for future employees.

2. In the absence of such stipulation, I recommend that the parties during their post-report negotiations consider the possibility of revised terms under the DB plan for future employees. The revisions I recommend they consider are the following:

a. 3% employee contribution.

b. Eliminating sick pay component of FAC.

c. Eliminating (or capping) overtime component of FAC.

d. Restoring 3 year averaging period.

e. Applying retroactive pay (and any other lump sum payout) to the applicable years.

3. I recommend that the parties should only agree to 2 if <u>both</u> parties find the revised formula acceptable for the foreseeable future. To this end (and mindful of the City's political history), I invite the parties to consider a provision that if any component of the new formula were to be changed by future City elected officials to the effect of increasing the required contribution for the DB benefit without an offsetting contribution from affected employees, the employees covered by the new formula would transfer to the DC plan.

4. If the parties are unable to agree on a revised DB pension formula and contribution for future employees, I would recommend a DC plan for future employees.

5. I also recommend that the parties during their post-report negotiations consider various aspects of the proposed DC plan for future employees. The aspects I recommend they consider include the following:

a. Increasing the total contribution (at least in early years of employment) to 15%. This could be done by increasing the employee contribution to 6% or by some other allocation.

b. Clarifying the meaning of the "wages" on which the percentage contributions will be based.

c. Discussing any other terms of the DC plan either party deems appropriate for consideration.

d. Reviewing procedures to assure that the new employees will receive sufficient education to make prudent investments.

6. I am not making a recommendation on the City's proposal to remove overtime or lump-sum sickpay from FAC for existing employees. (However, I do not mean to discourage the parties from discussing this issue in their post-report negotiations.)

7. I recommend that Local 1250's proposal for COLA increases for retirees under the DB plan not be adopted.

8. I recommend that Local 1250's proposal to add to the pension board a sixth pension trustee, who is a member of the pension system, not be adopted.

REASONS

Let me begin by saying that the question before the City and Local 1250 is to determine what would constitute an appropriate retirement benefit plan for future employees who have not yet been hired and who will become members of Local 1250. People of good will can disagree on the answer. The question is a far cry from an act of war.

City expert Leon LaBrecque testified that the goal for replacement earnings in retirement is 75% of wages.[39] The major sources of replacement earnings are pensions, social security, and personal savings. Reasons for not needing more than 75% include no (7.65%) social security tax, reduced income taxes, and reduced expenses (e.g., home usually paid off and children now adults).

In deciding whether to phase out a DB plan in favor of a DC plan, it is important to proceed with care.[40]

I will now turn to the reasons in support of my recommendations.

RECOMMENDATION 1:

One may support the concept of DB plans without supporting the components of a particular DB plan.

---

[39] "75% is considered, by almost all financial professionals to be the standard of wage replacement. That's what you should be shooting for." (Tr. I, 165-166).

[40] An AFSCME paper (U-88) offers the following cautionary words in a discussing changes from DB to DC plans:

> The basic purpose of a retirement system is to provide a secure and predictable level of income for former employees after retirement. DB plans do this. Replacing DB plans with DC plans effectively shifts the risk of investment from the employer to the employee and jeopardizes the retirement security of the individual. Plan sponsors and legislators may look to DC plans as a quick fix to funding their employees' retirement. We should be cautious not to let a decent retirement plan slip away for the benefit of non-career employees, or the benefit of those simply attempting to reduce spending on public employee benefits.

(I think that "jeopardizes" as a generalization is too strong a word.)

In the present case, it is necessary to balance (a) the risk of placing investment loss on future employees, and (b) the reality of the parties' current DB plan.

I believe that the current DB plan is very costly, rigid, a product (at least in part) of past City politics, and conducive to widely differing benefit levels.[41] I understand that there is nothing to be done about its unfunded liability of 8.20% of payroll. However, even its normal cost to the City of 16.50% of payroll (with no employee contribution)[42] is way out of line in comparison with comparable communities.[43] It is a drag on Warren's General Fund (and from written accounts in the massive record before me) its excesses have caused controversy in the City.

As to the proposed DC plan, I believe it can generate at least an adequate retirement benefit for future City employees. Further, DC plans lack the Constitutional rigidity of DB plans. Therefore, there is more leeway to make short-term adjustments to compensate for poor investments or any other contingency.

Further, while DC plans are the exception among public sector employers in comparison with DB plans, they appear to be

---

[41] The record establishes vast disparities of pension benefits for employees with comparable base salaries and years of service. See pp. 18-19, supra.

[42] As noted earlier, in 1980 bargaining between Local 1250 and the City, negotiations occurred involving a lower increase in wages for 1980 in return for the employees no longer being required to make contributions to the DB plan. (U-74). Since then, no employee contribution has recurred despite various enhancements of the pension benefit formula.

[43] See discussion of "normal cost," pp. 24-25, supra.

beginning to enjoy acceptance by neutrals. For example, in a recent Act 312 case, City of Livonia, MERC Case. No. D96 I-2157 (July 1, 1998)(C-15), Chairperson Theodore St. Antoine awarded a mandatory defined contribution plan for future fire fighters. In making the award, Chairperson St. Antoine was influenced by a trend in favor of DC plans:

> I ... realize that there is a nationwide trend toward defined contribution plans. As is said in a standard text, Steven L. Willborn, Stewart J. Schwab & John F. Burton, Jr., *Employment Law: Cases and Materials* 774 (2d ed. 1998):
>
>> Historically, defined benefit plans were the predominant form of pension plan. As recently as 1975, more than two-thirds of pension plan participants were in defined benefit plans (27.2 of 38.4 million participants).... In 1991, 58% of pension plan participants were in defined contribution plans. A number of factors contributed to the shift toward defined contribution plans, including economic factors (e.g., [slow growth in firms offering defined benefit plans]) legal factors (e.g., compliance with laws is more costly for defined benefit plans]), and the preferences of both employers and employees (e.g., defined contribution plans are easier to link with current performance and permit greater employee mobility). DOUGLAS L. KRUSE, PENSION SUBSTITUTION IN THE 1980s: WHY THE SHIFT TOWARD DEFINED CONTRIBUTION PLANS? (National Bureau of Economic Research Working Paper No. 3882, 1991).[44]

In another recent Act 312 case, City of Wyandotte, MERC Case No. D96 I-2777 (Dec. 29, 1998)(C-Brief-1), Chairperson Barry C. Brown awarded a mandatory defined contribution plan for future police officers. He appears to have made the award to

[44] **I note that this quotation appears to address the private sector rather than the public sector.**

provide some financial relief to the City and because of a trend in favor of DC plans:

> The city's proposal would establish a two-tiered pension plan which would provide a defined contribution plan for all employees hired after January 31, 1999. The city would make an annual payment of 10% of each employee's prior year's base salary. Under this proposal, all existing members of the bargaining unit would continue under the existing [DB] system, and yet, the city could see a resolution for its current expensive program. This is a new approach for employee retirement programs, and only Trenton and Brownstown now use it for their police employees. While it is new, there is a trend in this direction. Further, the city plan provides a reasonable method to establish cost control in the future, while at the same time providing current employees with a [DB] retirement program in keeping with their peers in comparable communities. Further, under the city's plan, the newly hired employees need not make any pension contributions, and so they could use this 5% savings to start their own savings program. For all of these reasons, the panel adopts the city's proposal.

Two factors relied on by Chairperson Brown -- (1) the city seeking "a resolution for its current expensive program," and (2) the proposed DC plan "provid[ing] a reasonable method to establish cost control in the future" -- are pertinent to the present case.

RECOMMENDATIONS 2-4:

It appears that Local 1250 and the City have yet to discuss the possibility of revising the current DB plan for new employees. Rather, Local 1250 proposed to maintain the status quo as to the current DB plan (which the City did not wish to discuss), and the City proposed a new DC plan for future employees (which Local 1250 did not wish to discuss).

I realize that this is a long shot. Both parties have spoken of the problems with "2 tiered" pension plans, and the City has the additional concern that nothing would be gained from a 2 tiered DB plan (other than employee contributions) if down the road a future City mayor and council were to agree to restore the changed components for the covered employees.

However, I think it would be a good idea in the post-report negotiating period for the parties to discuss whether there is any way in which the current DB plan could be modified in order to save it for new employees.

RECOMMENDATION 5:

A strategy for success with a DC plan is to get as much money into one's DC account as early as possible. The reason is simple: $1,000 earning interest (say at 7.5% annually) for 30 years will yield about $3,000 in interest, whereas for one year it will yield only $75 in interest.

In his 1991 fact finding report (C-5, p. 55), Barry C. Brown wrote:

> All new employees should start at the minimum rate bargained with the Union. If it is too low to attract competent employees, it then should be raised.

Because of the City's high compensation, it probably would not have a problem attracting competent employees even if they were to contribute 6% to their DC accounts in their early years of employment.[45] A new employee still would be earning more in net compensation than in comparable communities.

I also think that the parties need to be clear about the compensation to which the contribution percentages would apply. The ICMA prototype plan (U-92, p. 2B:10) defines "earnings" as follows:

> 2.09 Earnings. Earnings, which form the basis for computing Employer contributions, are all of each Participant's W-2 earnings which are actually paid to the Participant in the Plan Year, plus any contributions made pursuant to a salary reduction agreement which are not includible in the gross income of the Employee under section 125.402(a)(8), 402(h), 403(b), or 457(b) of the Code. Unless the Employer elects otherwise in the Adoption Agreement, Earnings shall exclude overtime compensation and bonuses....

As with any "financial" term of the DC plan, it may make a big difference under Article 9, Section 24 of the Michigan Constitution whether the controlling definition of "wages" or "earnings" is contained in the parties' collective bargaining agreement rather than in the plan.[46]

---

[45] The employee contribution would be made from pre-tax income. As a result, an employee in a 28% income tax bracket would be out of pocket only 1.8% for a 3% contribution, and 3.6% for a 6% contribution. (Tr. I, 185-186). Further, the contribution would be owned wholly by the employee with no City claim to it.

[46] See discussion of THE MICHIGAN CONSTITUTION AND GOVERNMENT PENSIONS, <u>supra</u>, pp. 33-37.

In its Brief, Local 1250 points out that there are several other issues pertaining to the proposed DC plan which the parties have yet to discuss. (U-Brief, pp. 76-81). These include (in addition to the meaning of "wages" or "compensation" or "earnings"): Break-in-service; minimum service; forfeitures; and voluntary employee contributions.

During the post-report bargaining period, the parties should discuss any such issue either party deems appropriate for consideration.

As to education, it is important for the parties to be assured that the new employees will receive proper instruction in making investments. This seems to me to be a special challenge as to young, new employees who are concerned about doing a good job (and starting adult life) rather than retiring.

<u>RECOMMENDATIONS 6 and 7:</u>

I am making no recommendation that the DB plan be changed in any way for existing employees.

As to the City's proposal to eliminate overtime or lump sum sick pay from FAC for existing employees, I am not making a recommendation on it (even if Constitutional and justified) because I think it would be neither constructive nor instructive to the parties for me to do so at this time.

As to Local 1250's proposal to add COLA to retirees' benefits, the short answer is: They do not need it.

RECOMMENDATION 8:

I am not recommending that a sixth pension trustee, who is a member of the pension system, be added to the DB Pension Board.

As I understand Local 1250's argument, the Pension Board is politicized in favor of a City majority; and, if employee representatives had an equal voice on the Board, they could "prevent abuse."

I am concerned that an "equally divided" pension board would produce "deadlock."

Under the law, pension board trustees are bound by fiduciary duty to act prudently and properly. If the trustees breach their fiduciary duty, they may be held liable in a court of law.

October 16, 1999

Respectfully submitted,

TL Gravelle

Thomas L. Gravelle
Fact finder