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ALTO SANITARY DISTRICT

P.O. BOX 163, MILL VALLEY, CA 94942 (415) 388-3696

05/24/07

To: The Honorable Lynn Duryee
Marin County Superior Court
P.O. Box 4988
San Rafael, CA 94913-4988

✓ Karin J. Hern, Foreperson
Marin County Grand Jury
3501 Civic Center Drive, Room 303
San Rafael, CA 94903

From: Tom Roberts, Manager TCR
Alto Sanitary District

Re: Response to Grand Jury Report dated 03/19/07

The Board of Directors of the Alto Sanitary District discussed the referenced report at length at their meeting of May 23, 2007.

The Board concluded that the findings and recommendations set forth in the report do not apply to this district as we have only one part-time employee (me) and the district extends no fringe benefits to its employee or themselves, the Board Members.

However, the Board takes exception to many of the assertions set forth in the report and its findings and recommendations. Enclosed herewith is this Board's rebuttal to the report.

Enclosure: Response to Grand Jury Report of 03/19/07

Alto Sanitary District
P.O. Box 163, Mill Valley, CA 94942 (415) 388-3696

May 23, 2007

Marin County Grand Jury
3501 Civic Center Drive
San Rafael, CA 94903

Re: Retiree Health Care Costs, dated March 19, 2007

Dear Members of the Grand Jury:

The Directors of the Alto Sanitary District have reviewed the above titled report and prepared the responses below pursuant to your request. For ease of consideration, we have set forth the requested findings of fact and recommendations in italics and immediately following each, set forth our response in regular type.

F1. Health care coverage is a valuable benefit to attract and retain employees.

The companies that issue credit ratings (i.e., Moody's Investors Service, Standard & Poor's, and Fitch Ratings) consider the importance of offering retiree health benefits in order to attract and retain qualified employees. One of the many factors that the companies take into consideration is the quality of the public employee workforce, as well as the ability of a government to get its work done. They recognize the governments must continue to be attractive places to work if they are to attract and retain qualified workers. They know that decisions to reduce or eliminate retiree health benefits can have an adverse effect on both the quality of the workforce and the willingness of experienced employees to remain on the job, although they would not presume to suggest what level of benefits is necessary in any particular situation.

It must be recognized that through the years, California state employees have accepted 20-year vesting for retiree health care, increased co-pays and deductibles, caps on benefits, and many have foregone salary increases to fund retiree or current health care. According to a recent study by California's state employee relations agency, the Department of Personnel Administration, "The State offers similar health benefits to those of other large private sector employers (1000 or more employees)." (Source: www.dpa.ca.gov/tcs2006/key-findings.htm)

Many other local agencies have similar requirements for employee contributions and/or cost sharing. Public employees have made sacrifices and trade-offs in order to receive adequate health care.

Just as in the private sector, most public employees and retirees contribute to paying their health care costs by making monthly premium contributions, by sharing costs through co-pays for the office visits and for prescriptions and myriad other payments.

F2. Government entities generally pay more of their compensation in the form of benefits than the private sector.

Retiree health benefits are not a gift of public funds, but an earned benefit. Many public employees have traded off pay increases, or agreed to pay more for current health benefits, in order to receive health care when they retire.

F3. Most government entities providing health care and other non-pension retirement benefits must disclose the future and accrued cost of those benefits to the public within the next four years pursuant to GASB 45.

The new rules do not change the current and future projected cash costs of providing other post employment retirement benefits. As such GASB 45 should not create in any crisis in the minds of the public or their elected representatives.

F4. Government budgets and union negotiations will be affected by the implementation of GASB 45.

GASB 45 does not change an employer's fiscal situation, nor do the rules affect the cash costs of benefits. The new accounting standards do not change the promises made to employees in return for their hard work and loyalty. The gap between the total future costs of retiree benefits and the dollars set aside to pay for them will not change because of any GASB requirements either.

Curiously, the new GASB 45 rule focuses only on employee retirement benefits (other than pensions), while ignoring other accounting issues that occur in the same time frame and also have significant impact on government balance sheets. Other long-term liabilities, such as Medicaid, public education, and incarceration are not reported. Nor does the new set of accounting conventions recognize capital assets held by governments such as roads, real estate and infrastructure which in the private sector would be reflected on the entity's balance sheet and would be used to offset liabilities.

GASB 45 does require employers to recognize the cost of the retiree health program over employees' lives before cash payments are made. Under GASB 45, all parties will know what the actuarial liability (as distinguished from actual liability), financial statement annual costs, and financial statement liabilities are.

The requirement to disclose costs may dramatically affect the political situation surrounding employee benefits. This may be acute where elected officials and employers react to misinformation about GASB and/or fear political backlash against the scale of the dollars disclosed. If employers go into bargaining and make offers based on bad information that suggests they must act immediately to set aside dollars to pay down GASB disclosed liabilities, negotiations will be unnecessarily confused and complicated. Elected officials and employers must ensure that they are well informed, not manipulated

by bond vendors, lawyers, consultants and brokers intent eagerly pushing their products and services as solutions to what they call problems. Elected officials and employers must approach the bargaining table committed to honor past promises to employees who have past their productive years and may be reliant on promises of health care.

It must be remembered that health care is not a luxury you can simply forgo. Many public employees do not receive Social Security. So, cutting their retiree health care benefits could force them to choose between eating and getting medical help. Or it could force them to rely on public health services to make ends meet, which means taxpayers get stuck with the bill anyway.

Elected officials must be cognizant of the lessons learned from the private sector where private businesses have confronted these actuarial projections and frequently sought to limit their own liabilities. Some tactics - like cutting off benefits – simply move the liabilities off their books and make them a public cost, as retirees are forced to rely on the public health systems. Many public employers understand that they will simply be moving this liability for providing health care for the aged from employee benefits to public health care line items, which does not, in the end reduce the overall costs to government.

Additionally, the suggestion at page 9 of the Grand Jury Report that there is "some appetite" to create tiered benefits, by i.e., elimination of retiree health care coverage for new employees is extremely short sighted. The crisis we are facing is the skyrocketing cost of health care for (which we spend more per capita on than any industrialized nation, but find ourselves ranked on quality in the company of second and third world nations): Creating smaller life pools adversely affects insurance rates, driving the cost of benefits ever higher. Only by maximizing the size of the life pool and instating cost controls on pharmaceutical, hospital, and other medical costs do the insurance rates and consequently cost to the employer come down. Responsible public employers will take this high road on the health care crisis by joining the fight for a solution, i.e., SB 840 Single Payer – "Medicare for All", instead of joining the rush to the bottom or implementing a risk shift that is economically unsound and flawed as a public policy.

Credit rating firms - Moody's Investors Service, Standard & Poor's, and Fitch Ratings – will undoubtedly view more favorably an employer who works with employee groups on a thoughtful plan and creates a lasting consensus over an employer that leaps to a quick, but poorly thought out action. (See response to F8, *infra.*) While government entities should not take credit ratings lightly because they can affect the cost of borrowing, an employer who talks too loudly at this early date about bond ratings may be using this matter as a pretext to advance other agendas.

F5. Unless legally determined otherwise, the issue of vesting for retiree health care benefits requires a fact specific analysis.

GASB is not an employment law; it is an accounting rule intended to add information to balance sheets. That information is based on specific promised benefits, which the GASB defines as the "Substantive Plan": the plan for retirement benefits as it is understood by employers, employees, retirees, etc., and is based on information in plan documents, collective bargaining agreements, employee communications, etc.

Whether employees vest in retiree health benefits, or under which circumstances these promises are legally enforceable is not the subject of GASB 45, but are legal issues that might be raised if governmental entities renege on bargained commitments to retirees.

The GASB has rejected arguments that OPEB's are not guaranteed or vested, but contingent upon periodic authorization by the employer, which is indicative of a right to modify or discontinue benefits, and therefore should not be account for as a long-term commitment. GASB rejected this argument that employers could avoid booking OPEB's based on the possibility that an employer might, at some time in the future, discontinue its pattern of providing OPEB. GASB has stated in correspondence with the NEA:

> The cost associated with an employee's post employment benefit is deemed to be incurred, and conceptually should be recognized, in the years during which the employer receives services rather than during the post employment period when payments are made – and – The employer has a constructive, if not legal, obligation for promised benefits to the extent the benefits are attributable to services already received and its is probable that conditions for an employee's eligibility to receive benefits will be met.

F6. Some government entities have not done the extensive research to determine if retiree health care benefits and the manner in which they are calculated are vested or can be changed or eliminated.

See, F5, *supra.*

F7. Public comments on vesting by government entities could result in creating a vested right when none previously existed.

See, F5, *supra.*

F8. Unless government employers prudently manage the liability for retiree health care benefits, they will be forced to cut services, reduce benefits, and/or raise taxes to satisfy credit agencies.

Moody's Investors Service, Standard & Poor's, and Fitch Ratings have said they do not expect to see large-scale deterioration of credit ratings based on the way governments start to report their retiree health care liabilities. Standard & Poor's put it this way: "We believe that, with or without the prefunding of OPEB liabilities, most employers will be able to continue to meet their ongoing OPEB cost requirements without an adverse effect

on credit quality. OPEB costs will be worked into budgets and will need to be addressed, along with other normal costs of providing services." (Standard & Poor's, "OPEB Liabilities Pose Minimal Near-Term Rating Risk for Public Finance Credits," December 4, 2006, p. 2.)

All government employers are in the same boat. Credit rating agencies have indicated they will move carefully and with deliberation until they can see how employers are dealing with both GASB and the information that comes forth.

The companies that issue credit ratings want to see that governments are taking OPEB liabilities seriously. However, an employer that rushed to develop and implement plans could cause more problems than it resolved. Indeed, there are no deadlines for employers to develop and implement plans for addressing unfunded liabilities. Credit-rating companies know that governments will need time to study the situation, work with stakeholders, and develop their plans, and they know that it could take years to fully implement plans. Further, employers' plans are likely to change over time. Note, however, that GASB 45 has established formal deadlines for implementing the new accounting standards; the GASB timetable refers only to calculating and reporting liabilities.

Blanket statements about unfunded liabilities leading to credit downgrades are not credible, although there may be situations in which a detailed analysis of a government's finances and management leads to legitimate concern about its credit rating. There are just too many factors in play, and this issue is far too new, for generalizations about credit ratings to be taken seriously.

F9. Financially weak government entities faced with staggering liabilities will be required to reduce benefits, raise taxes or reduce services. Failure to manage the liability could well result in bankruptcy for those government entities.

The mere existence of unfunded liabilities does not necessarily hurt a government's credit rating. In part, this is the case because unfunded liabilities must be looked at in a much broader financial and management context. And, in part, this is because a government may be able to handle its current and future retiree health care obligations without creating financial risk.

Right-wing think tanks are releasing white papers arguing that public employee benefits are bankrupting local governments. Local ultra-conservative anti-government groups are demanding that elected officials cut back these benefits. The news media have often picked up these arguments and reported them uncritically, often adding weight to these views simply by repeating them, and at other times by writing slanted editorials.

Public employers should not imitate the shameful behavior of private sector employers who declared bankruptcy (after raiding pension funds, as well) and cancelled long-promised retiree health insurance.

The real crisis is in the skyrocketing cost of health care for every California and American. People on all sides of the issue agree – Democrats, Republicans, and non-partisan legislative analysts – that the best way to address the issue of OPEB is not to eliminate or cut health benefits, but to stabilize the costs now and pay for future retiree health care costs. Instead of eliminating or cutting the earned benefit of health care, government entities should be seeking to hold the executives of the drug companies, hospitals, and insurance companies accountable for the outrageous costs which harm all Californians. A sound public policy makes access to essential, quality medical services available for all Californians, especially seniors and retirees. (See, pending SB840, Single Payer Health Bill – "Medicare for All".)

There is a very real alternative to joining the race to the bottom: SB 840 provides for affordable health care. Health benefits will be paid for by federal, state and county monies currently being spent on the health care system and affordable insurance premiums that replace all premiums, deductibles, out-of pocket payments, and co-payments now paid by employers and consumers. System savings resulting from use of the state's purchasing power to buy pharmaceuticals and medical equipment at discounted rates, administrative simplification, and making primary care and preventive care available for everyone will dramatically increase the funds that can be spent on providing universal coverage. According to the Lewin Group study, even after care is made available to California's uninsured and underinsured, the net state savings will be about $8 billion in the first year. (See, http://www.healthcareforall.org/lewin.pdf.)

SB 840 provides for efficient delivery of health care. Waste will be eliminated by consolidating the functions of many insurance companies into one comprehensive insurance plan saving the state and consumers billions of dollars each year. A recent Boston University study shows half of every dollar spent on health care is squandered on clinical and administrative waste, insurance company profits and over-priced pharmaceuticals. The Lewin Group report estimates that California will save more than $20 billion in reduced administrative costs in the first year alone. (See, http://www.healthcareforall.org/lewin.pdf.)

SB 840 provides for high quality health care. Consumers will have total freedom to choose their personal primary care provider. Health care providers and facilities will receive fair reimbursement for all covered services they provide. SB 840 provides for generous health care benefits based on all care prescribed by a health care provider that meets accepted standards of care and practice. The benefit package is broader than that of many current health plans and includes hospital, medical, surgical, and mental health; dental and vision care; prescription drugs and medical equipment; diagnostic testing; emergency care; health education and translation services; hospice care; and more. SB 840 will stabilize the growth in health care spending by linking spending increases to growth in state gross domestic product and population, employment rates, and other relevant demographic indicators. It includes cost controls and an emphasis on preventative and primary care.

F10. The municipalities and special districts have not taken appropriate aggressive steps to understand and begin to comply with the requirements of GASB 45.

Municipalities and special districts must realize that GASB 45 is not the crisis: The out of control cost of health benefits (and total lack of correlation between cost and quality) are the real crisis. Municipalities must realize that GASB 45 only requires that the OPEB unfounded liability is reported, not that it is paid off early (in simplest terms of thinking, GASB 45 is analogous to a mortgage where the loan payment schedule shows a sizeable debt based on purchase price and the amortized payments, but the actual monthly payments are manageable: In other words, pay-as-you go, not pre-funding.) Municipalities and special districts must realize that a host of profiteers will seek to offer assistance out of the so-called OPEB crisis, for a price: The municipalities and special districts should be cautious of the bond vendors, lawyers, consultants or brokers supplying information or products related to GASB 45 compliance and highly critical of those rushing funding and/or abrogation of collective bargaining agreements.

Appropriated steps that municipalities and special districts should be aggressive in taking are the following:

a. Assemble documents describing the benefit program(s), which could include such documents as collective bargaining agreements, employee benefit handbooks, memos, etc. But, GASB 45 defines the benefits plan as more than the plan as described in documents. Any oral understandings and past practices, whether written or not, are part of the "substantive plan."
b. Identify OPEB programs. What are the benefits (other than pensions) promised to retirees? If they are not the same as those benefits afforded active employees, only those benefits that retirees receive should be used in calculations. (Those on active service are not included for health and other non-pension benefits they receive while working; only those that they will be receiving after retiring).
c. Develop a census of employees, retirees and dependents covered under the OPEB programs. The census should include key items used to determine when benefits start and stop (such as retirement date, birth date, hire date, etc.)
d. Separate the costs for retirees (including both retirees who retire young or do not qualify for Medicare, and those over 65 who are enrolled in Medicare) , from active employees for current programs. The "implicit rate subsidies" for retirees – where retirees are insured as a group with active employees and pay the same health care premiums as actives instead of the higher premiums they would pay if insured separately – should also be broken out. Nb. If a plan is "community rated" then there is no need to calculate or to report any liabilities related to the "implicit rate subsidy" defined in GASB 45 (e.g., CalPERS Public Employees' Medical and Hospital Care Act (PEMHCA) health plan, see, CalPERS Circular Letter No. 200-017-07, dated April 4, 2007).

e. Separate medical costs for those retirees enrolled in Medicare, and those not eligible (retired, but too young to receive Medicare, or otherwise not eligible).
f. Engage a qualified actuary to calculate the total projected liability of the program. The scope of work for the actuary should include not only the total projected liability of the OPEB program, but also the GASB annual "Normal Cost" and "Actuarial Accrued Liability" (AAL), as well as the Unfunded ALL (UAAL).
g. Comply with the reporting requirements as based upon total budget.

F11. Whether elected or appointed, public employees managing the retiree health care liability may also be eligible to receive the retiree health care benefits they manage. They are subject to a conflict of interest.

Additionally, whether elected or appointed public employees managing GASB 45 compliance who derive income directly or indirectly from bond vendors, lawyers, consultants or brokers supplying information or products related to GASB 45 compliance are subject to conflict of interest.

R3. All municipalities and special districts do extensive research on the facts and seek professional help to determine vesting issues. This should be done by the end of 2007.

See F5, *supra.*

R4. The county, all municipalities and the special districts offering health care benefits consult with professional advisors to state clearly in employee and public communications whether retiree health care benefits are vested and the extent to which they can be changed, modified, or eliminated.

See F5, *supra.*

R5. Unless they are certain of the status of vesting for retiree health care benefits, no government entity should comment publicly on the question of vesting because doing so may create a vested right where none exists currently.

See F5, *supra.*

R6. The municipalities and special districts take immediate, aggressive steps to understand now the requirements of GASB 45 reporting and that these entities, including the county, begin using the information generated for GASB 45 in labor negotiations and in budgeting.

See, F4, F8, and F9, *supra.*

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Conclusions

Less informed entities should not be driven to despair or thrown into crisis management modalities by the sub-title of the report ("I think I'm gonna [sic] be sick"), reinforced by such statements as: "...they should consider ...reducing or freezing retiree health care benefits for current employees and/or retirees and reducing or eliminating them for new hires" (GJR p2), "health care is in the news because of what appears to be an impending crisis centered[1] on the ability of government entities to pay their obligations or even understand the future impact of their obligations" (GJR p3), "It will also impact negatively the entity's credit rating and therefore its ability to borrow money at a reasonable rate of interest" (GJR p4), "Bankruptcies or a "death by a thousand cuts" in services are real possibilities" (GJR p4). Government entities should be wary of adopting such speculative and/or dubious statements as fact. Government entities should not react in panic as if GASB 45 created a new liability; GASB 45 merely makes existing liabilities transparent by requiring that they be booked.

Rather than join the private sector's unconscionable race to the bottom, and shifting risk to those who cannot bear the risk to increase the profits of a health industry run amuck, public entities should adopt policies that protect living breathing citizens from rapacious corporations that are making indecent profits to the harm of the public. The existing structure of providing health coverage in the United States is irreparably broken. As demonstrated in the Lewin Report, SB840 would provide a comprehensive solution to the problem – a broken "system" of health care – and in the process alleviate the symptoms, i.e., all GASB 45 liability predicated on health benefits, and the embarrassing fact that over 4.5 million Californians (80% of whom work) are uninsured. All Californians should have access to essential, quality medical services: Suggesting that we will get there by stripping public employees of earned benefits is not the solution and by treating a symptom rather that the cause will only aggravate the problem.

Respectfully submitted:

Stanley J. Bransgrove
Director/Chair
Alto Sanitary District

Tom Roberts
District Manager
Alto Sanitary District

Joyce Miles
Director/Secretary
Alto Sanitary District

Public Hearing: May 23, 2007
Adopted: May 23, 2007
Ayes 5
Nays 0
Abstention 0

[1] This misidentifies the center of the crisis which is rampant greed and overpricing by the health industry.