REPORT OF THE
CHIEF LEGISLATIVE ANALYST

Date: August 9, 2013

To: Councilmember Herb J. Wesson, Jr., President
Councilmember Mitchell Englander, President Pro Tempore

From: Gerry F. Miller
Chief Legislative Analyst

Suject: **ANALYSIS OF IBEW PROPOSAL**

SUMMARY

As you requested, we have analyzed the proposed agreement between the City through its Department of Water and Power (DWP) and the International Brotherhood of Electrical Workers (IBEW). The proposal calls for a four year Memorandum of Understanding (MOU), the establishment of a new DWP pension tier and resolution of ligation involving reciprocity between the DWP pension system and the City's Los Angeles City Employees' Retirement System (LACERS).

In conducting our analysis, we consulted with the Office of the City Administrative Officer (CAO) and the DWP in verifying certain cost and savings projections. We did not, however, consult with either on our analysis and conclusions. The conclusions we reach are based on our own independent assessment of the proposal as presented and the implications of the various decisions before the Council.

Our analysis focuses on the following four threshold questions which are discussed further below:

1. **QUESTION:** Does the proposal substantially conform to the principles established by the Mayor and Council in approaching labor negotiations over the last several years and result in significant savings to City taxpayers and DWP ratepayers?

   ANSWER: Yes. In all material respects the proposal complies with the established negotiation goals, including elimination of new COLAs, contributions to retiree and active duty health care costs, a new sustainable pension tier and, in the case of DWP, addressing salary disparity that negatively impacts the ratepayers and City operations.

2. **QUESTION**: How does the potential outcome of ongoing litigation relative to pension system reciprocity impact decision making?

ANSWER: Litigation risk avoidance is not the core basis for approving the transaction. Settlement to the litigation is a means to an end that will accomplish a variety of policy and strategic goals while eliminating any risk from current litigation altogether.

3. **QUESTION:** Does the City have a reasonable expectation of achieving better results in open contract negotiations if the proposal is rejected and the current MOU with IBEW expires in June of 2014?

   ANSWER: No. Based on our analysis we find it extremely unlikely that the City could even achieve the same results as the proposal before the Council, let alone achieving better results.

4. **QUESTION**: How does the decision made relative to the proposal impact the bargaining environment with all of the other City labor unions with which the City will be in negotiations within the next 12 months.

   ANSWER: We believe that approval of the proposal will provide the best opportunity to establish a framework for achieving our required objectives over the next several years with all of the City's unions.

The following presents a summary of the major deal points with emphasis on the elements of the proposal which are pertinent to the conclusions we have reached. The details of the proposal have been reported separately by the CAO and discussed at length in the Executive Employee Relations Committee (EERC) and before the full Council immediately after the new members assumed office. Additionally, individual briefings have occurred. Those discussions have been occurring over the past 18 months and have, by necessity, occurred in closed session to protect the confidentiality of the labor negotiating process as well as to comply with a gag order imposed by the Court in connection with the litigation. Of course, at the time the proposal is brought before the Council for approval, it will have to be heard in open session and all of the details of the deal will be subject to public scrutiny and debate.

We also spoke with the DWP Ratepayer Advocate and his staff. Because they are not part of the labor negotiation process, they have not been provided detailed information on the proposal. They have, however, been provided with summary data on elements of the proposal and the impact on water and electricity rates. Based on their initial review they have stated that it appears that the proposal reaches or exceeds their expectations in what the City could achieve in the near term relative to salary cost reduction and pension reform. Some additional information on their feedback is provided under Question 3 below.

In reviewing the results of our analysis and determining the direction in which to take, it is important for the Council to keep in mind that, although you are faced with making a decision by September 1, the due diligence that led to the matter before you has been ongoing for some time and this is not the only opportunity the Council will have to make progress with IBEW negotiations. It will take some time and more than one round of contract negotiations to achieve all of the City's goals. The question before you is whether significant progress has been made and whether additional progress in the near term can be achieved through rejection of the proposal.

In light of the above and what follows, we strongly urge the Council to approve the proposal before you. It accomplishes the negotiating goals established several years ago with all labor negotiations, will provide the greatest protection to DWP ratepayers, creates certainty over the next several years in DWP revenue requirements and rate impacts on customers and provides a framework for ensuring that negotiations with other City unions result in an outcome that is consistent with cost containment measures that are essential in bringing the City's General Fund into structural balance over the next few years.

DISCUSSION

1. Does the proposal substantially conform to the principles established by the Mayor and Council in approaching labor negotiations over the last several years and result in significant savings to City taxpayers and DWP ratepayers?

Yes. Over the course of the last few years, the City has focused on several stated principles in labor negotiations:

- New Pension Tiers
- Contributions by active employees for healthcare premium.
- Contributions by active employees for retiree healthcare.
- Reducing Salary Costs

The City has applied these principles to our City workforce. New pension tiers have been established for both the civilian and sworn work force. Members of a number of bargaining units (approximately 25% of the City workforce) are now contributing 5% of the healthcare premium with three smaller units contributing 10% beginning in 2014. Current sworn and civilian employees are now contributing up to 2% and 4%, respectively, for retiree healthcare costs.

With regard to reducing salary costs, the City in conjunction with out labor partners have deferred, eliminated and/or modified scheduled pay increases. Agreements with the Coalition of Los Angeles City Unions were extended for this purpose. With an original expiration date of June 30, 2012, the term was extended through June 30, 2014 and included such modifications as deferring cost of living adjustments, deferring cash payments for sick leave and the Early Retirement Incentive Program, reduced work schedules, elimination of bonus compounding and converting pay increases for days off. In addition, the entry level salary for police officers was reduced by 20%.

Comparison between IBEW Proposal and City Labor Negotiations
The proposed agreement with IBEW conforms with the approach we have taken with our City labor negotiations:

- A new pension tier would be established, significantly decreasing DWP's pension obligations over time.

Pension Tier Comparison

Plan Design Features	LACERS Tier 2	DWP New Tier	State Pension Reform
Retirement Factor	2.0%@ age 65 (Prior 2.16%@ age 55)	2.1%@ age 63 (Prior 2.30%@ age 55)	2.1%@ age 63* (Prior 2.30%@55)
Max. Pension as % of Final Salary	75% (Prior 100%)	80% (Prior 100%)	100%
Pension Calculation	Highest 36 Months (Prior- highest 12 months)	Highest 36 Months (Prior- highest 12 months)	Highest 36 Months
Employee Contribution	Approx. 9%**	7%	7%
COLA	2%, no bank (Prior- 3% with bank)	2%, no bank (Prior- 3% with bank)	CPI 2% min., 5% max
Spousal Continuance	50%	50%	up to 100%

* Increases to 2.5% @67; No additional factor for LACERS Tier 2 or DWP
** Subject to recalculation every three years to fund 75% of normal costs and %50% of unfunded costs.

- A contractually obligated COLA of 2-4% depending upon CPI would be deferred from October 2013 to October 2017.
- The range of the contractually obligated COLA would be reduced from 2-4% to 0-4%, based on CPI.
- There would be no COLAs in the interim. The last time IBEW had a zero COLA was over 20 years ago in FY1992-93.
- Starting salaries for 28 entry level classes common to the rest of the City would be lowered to either similar or, in some cases, less than salaries paid for the same positions in other City departments.
- New contracting provisions would be established which will lower the cost of contracting out some functions.
- Funding that would have gone to the contractually obligated COLA would be used for retiree and active employee healthcare.

- The proposed contract will provide a basis to achieve more of the City's goals, such as increased contributions to employee healthcare and other work rule changes, in subsequent negotiations.

Budgetary Savings

The joint CAO /DWP Report identified estimated savings of $6 billion ($2.5 billion due to the new pension tier, plus $3.5 billion from COLA savings) over a 30- year period, $464 million of which would occur during the four-year period of FY2013-14 through FY2016-17. We have reviewed the underlying documents and assumptions made to support these estimates. Because many assumptions are necessary to make projections over such a long duration, the original amounts in the joint CAO and DWP report inadvertently contained a mix of gross savings plus present value savings. In addition, the original estimate contemplated the immediate implementation of a new pension tier, which is not realistic. We believe the estimates should be revised as follows:

- The estimated 30-year *present value* savings will be in the range of $4 billion. The *gross* savings will be in the range of $7.9 billion over 30 years [comprised primarily of $4.2 billion due to the new pension tier plus $3.5 billion due to the compounding effect of zero COLAs for three years (FY2013-14 through FY2015-16)].
- The $4.2 billion pension savings was determined by the City's actuary, Bartel Associates.
- The $3.5 billion COLA savings was determined by DWP staff.
- During the four-year term of the proposed agreement, total savings will be $415 million
- The primary driver of the savings is the new pension tier and the reduced salary base from delaying the contractually obligated COLA for 3 years. Nominal savings are anticipated from the establishment of lower starting salaries for common classes, changes in the sick time policy and contracting out provision changes. The increased contributions for active employee and retiree healthcare are being paid from COLA deferrals. Since the savings from COLA deferrals has already been counted, there is no additional savings from this shift of COLA funds to pay for healthcare contributions.

Healthcare Contributions

The DWP is contractually obligated to provide funding for all retiree and active employee healthcare costs. These costs are included in the DWP financial projections. The proposed agreement directs the savings from the deferred COLAs toward contributions for retiree and active employee healthcare. In FY13-14 and FY14-15, the DWP will contribute on behalf of employees, 2% of pay for retiree healthcare and 1% of pay for active employee healthcare. In FY15-16 and FY16-17, the DWP will contribute on behalf of employees, 4% for retiree healthcare and 2% of pay for active employee healthcare. Continuation of these contributions on behalf of employees will be the subject to negotiation in future MOUs.

- This proposed agreement will not reduce the take-home pay for current employees. However, this proposed agreement **stops** an increase in take-home pay that would start in October 2013.

- While DWP employees will not see a change in pay, the deductions for healthcare costs will be shown on the paystubs. This creates a foundation for continuous healthcare reform.
- It should be noted that the COLA and healthcare contribution was handled differently in the City. Impacted City employees received a COLA, and then, in turn, made a contribution for active employee healthcare. This resulted in increased costs to the City because the salary base increased, resulting in additional pension contributions for actuarially accrued liabilities. The structure in the IBEW proposal is more cost-effective because the employee salary base is not increased by giving a COLA, and, instead, the funds would be directly applied used to offset healthcare costs.
- Also, it is noted that the healthcare contribution for active DWP employees is calculated differently when compared to those City employees who are making active healthcare contributions. The proposed DWP employee contribution is based on a percentage of salary whereas City employees who contribute to active healthcare pay a percentage of the premium. The DWP proposal may generate more savings than the City model, if it is continued in future MOUs, because it is structured as a percentage of a high average salary and the contribution is fixed regardless of the enrolled health plan. The following chart demonstrates this difference based on the current year:

Healthcare Contribution Model	**Basis**	**Savings**
2% of Salaries	IBEW Total Salaries of $897M	$18M
10% of Premium	IBEW Premium costs of $11.8M/month	$14M

- The following table demonstrates the amount of the healthcare subsidy that would be paid by DWP employees, based on salary:

DWP Premium Cost per Pay Period	Kaiser Employee Only = $276.99	Kaiser/ Anthem HMO Family= $783.88	Anthem PPO Family = $1,133.91*
DWP Employee Subsidy at 1% of Salary (Average DWP Salary = $98,922)	$37.90	$37.90	$37.90*
DWP Employee Subsidy at 2% of Salary (Average DWP Salary = $98,922)	$75.80	$75.80	$75.80*
DWP Employee Subsidy at 1% of Salary (DWP Salary = $150,000)	$57.47	$57.47	$57.47*
DWP Employee Subsidy at 2% of Salary (Average DWP Salary = $150,000)	$114.94	$114.94	$114.94*

*The percentage of salary model should be adjusted in future MOU discussions so that savings are not dissipated by "flight" to more expensive healthcare plans.

- For informational purposes, the City premiums and City subsidies are as follows:

City Premium Cost per Pay Period	Kaiser Employee Only = $251.14	Kaiser Family = $652.93	Anthem PPO Family = $811.02
City Employee Subsidy at 5% of Premium Per Pay Period	$12.56	$32.65	$190.74
City Employee Subsidy at 10% of Premium Per Pay Period	$25.11	$65.29	$223.38

Impact on Water and Electric Rates

This proposed agreement will reduce required rate increases for both water and electricity. Water bills would be 1.8% to 2.6% lower than what would be necessary and electricity bills we be 1.2% to 1.8% lower as a result of the pension and active employee cost reductions.

Conclusion

Approval of this proposed agreement is not a final action. Implementation would be dependent upon a number of future actions such as ratification by IBEW and approval of new MOU by the Board of Water and Power Commissioners and City Council, review and execution of a formal settlement agreement in the *Romero* case, completion of actuarial studies, approval of a new pension tier, etc.

Does the proposed agreement provide complete resolution to all of the City's needs? No. It is unreasonable to expect that all issues can be resolved in one round of negotiations. What this proposed agreement does provide is certainty. It provides billions in pension and salary savings over the next 30 years. It will reduce future projected rate increases. It makes progress for the first time in history with IBEW on active employee healthcare contributions. It begins to address the salary disparity in common classes. It resolves pending litigation. It removes risk in the near-term and provides a template for future labor negotiations. As we discuss throughout this report, we do not believe that the City will be as successful in making the same progress in these areas in open contract negotiations over the next four years.

There are many areas that require further progress in future contract negotiations. We need to continue to address salary disparity for ALL common classes, including not only lower starting salaries but also eliminating steps at the top end of the ranges. Additional progress must be made on increasing active employee healthcare contributions. The current proposal includes language enabling the City to review all side agreements relative to compensation and work rules, but we need to ensure that additional side agreements do not occur. In that regard we have worked with the DWP to identify potential financial impacts of various negotiating points. Details of those elements should be discussed in closed session as they would directly result in future negotiation instruct.

2. How does the potential outcome of ongoing litigation relative to pension system reciprocity impact decision making?

The Council's consideration of the proposal should not be focused on the risk to the City of the possible outcome of the litigation. The nature of the litigation is discussed below. As with any litigation, the City Attorney has not advised that the City faces no risk. Possible settlement of the litigation should be viewed as an opportunity to accomplish several policy goals that will, at the same time, eliminate litigation risk no matter how minimal.

Under the current pension reciprocity arrangements between LACERS and DWP pensions, when an employee moves between the two systems, they take with them all of their previous seniority and their own pension contributions, but the City's contributions stay with the original pension system. The result is that the transferred employee creates an increased unfunded pension liability in the new system. Since the majority of movement occurs from the City to the DWP, particularly over the last several years as substantial General Fund positions were eliminated and employees were transferred to vacant positions in the DWP, the impact on the DWP pension system has been significant.

In 2011, the DWP Board voted to eliminate reciprocity, and under its Charter Section 245 authority, the Council asserted jurisdiction over the DWP Board decision and disapproved it. As a result, reciprocity remains in place. The core of the litigation is the assertion that the City acted unlawfully when it overturned the DWP Board decision and that the City owes the DWP pension system approximately $200 million as compensation for City employees who moved to the DWP. That obligation would largely impact the General Fund.

We believe that it is in the interests of the DWP ratepayers and City taxpayers to end reciprocity, but if the City is successful in the litigation, the reciprocity arrangement will stay in place. Unless the City and DWP subsequently ended reciprocity anyway, either the DWP ratepayers or the City taxpayers who are, of course, largely the same, would be impacted. Either DWP ratepayers will foot the bill in that DWP's pension obligations are increased and those obligations must be covered through water and electricity rates, or the General Fund would foot the bill if the City agrees to transfer the City contribution for a LACERS member to DWP when they transfer. To avoid either scenario, the City would have to end reciprocity. That is, we believe, the desired result and would also be the result of the settlement. Additionally, the City would not be faced with the potential $200 million liability for past transfers and would end its efforts to defend the litigation.

It should be noted that ending the existing reciprocity agreement would not prevent employees from moving from the City to the DWP and vice versa. The difference is that the employee, rather than the ratepayer/taxpayer, would have to make the DWP pension system whole through increased payroll contributions. The employee would take that into consideration in making career decisions. An employee with few years in LACERS could move relative easily to the DWP because the increased pension contributions would be affordable and spread over the remainder of their career. However, the more time an employee spends in LACERS, the more costly it would be to cover the additional pension costs after transferring to DWP. That employee could then decide to either make the additional contributions or continue with both pension systems and receive reduced payments from both systems upon retirement.

An additional benefit to ending reciprocity would be to slow the "brain drain" to the DWP. Many department managers have expressed great frustration over the years in hiring and training employees, only to find that their employees transfer to the DWP for higher salaries and a better pension system. While it is difficult to quantify the impact of the City of this employee migration, there are clearly significant cost and operational impacts.

In summary, the impact of the litigation on the evaluation of the IBEW proposal is not litigation risk avoidance, it is to use the litigation as a platform to accomplish a variety of public policy goals while at the same time eliminating the risk altogether. The City has the opportunity to end reciprocity while implementing a multi-year contract with IBEW that substantially complies with the base-line goals of labor contract negotiations and locks in substantial savings over the contract period; allows for the implementation of a new pension tier that provides significant, long-term cost savings; and, establishes a framework that will help the City achieve its General Fund required cost reductions through negotiations with other City unions.

3. Does the City have a reasonable expectation of achieving better results if the proposal is rejected and the current MOU with IBEW is allowed to expire in June of 2014?

No. In open contract negotiations it would be very difficult to achieve equivalent results over the period. The chances of achieving better results are extremely remote. We base this conclusion on the following:

- No COLAs for the following three years would not be sufficient. Employees will have received a COLA in October of this year and new common class employees will continue to be hired at substantially higher salaries. To achieve results equivalent to the proposal, salary/compensation give-backs would be required.
- Glendale's recent unilateral contract implementation which included a 1.75% salary reduction for IBEW members has been mentioned as a template for the City to use proceed with IBEW at the DWP. We do not believe the Glendale contract provides a valuable template for several reasons.

    - Glendale's action was to unilaterally implement and it took an extended period of time to reach that result. There is no reason to believe that IBEW will agree to a contract with salary reductions at the DWP since they didn't agree in Glendale.
    - There are only approximately 300 employees involved as opposed to the more than 8,000 represented by IBEW at DWP.
    - The imposed contract expires on June 30, 2014. While Glendale employees did see a 1.75% reduction in 2014, it is impossible to determine over the following three years what Glendale may agree to relative to compensation adjustments for employees. The IBEW proposal before the Council, however, includes a 2013-14 salary give back of approximately 2% (estimated COLA increase that is contractually obligated in October of 2013), and a guarantee of no COLAs in the three subsequent years. It is true that the 2% raise which is due in October will be paid in October 2016 (0% to 4% depending on the CPI at the time), but the overall impact on employees in the two agencies cannot be compared over the time period since no information on Glendale is available beyond the current fiscal year.
    - Glendale does not have their own retirement system. They are members of CalPers which as discussed above, provides more generous pension benefits than provided for in the new DWP pension tier. It is not possible, therefore, to develop a comparison of the relative impacts on the two agencies.

- Since there should be no expectation that IBEW will agree to new contracts that reduce compensation, the City will have to be prepared to ultimately unilaterally impose a contract which reduces compensation.
- The process and implications of broad-scale repeated unilateral contract imposition must be seriously considered. In order to unilaterally implement a contract, the City must do the following:

  - Enter into good-faith negotiations with IBEW. Proposals and counter proposals must be made and seriously considered by both parties.
  - After substantive on-going negotiations, the City would have to make a "last-best-and-final" offer.
  - Only when IBEW formally rejects the officer, or after some period of time during which there has been no response, the City could declare an impasse and file with the Employee Relations Board (ERB).
  - The ERB would then appoint a hearing officer who would conduct investigations and hearings and advise the ERB as to whether he or she agrees that the parties are at impasse. Concurrently, Unfair Labor Practices claims by the IBEW to the ERB should be expected, which will also require assignment of a hearing officer, hearings and investigations and a decision by the ERB.
  - If, in fact, an impasse has occurred, the ERB will then appoint a fact-finder who will gather information from both parties and opine as to the reasonableness of the parties' positions.
  - That information would then go to a mediator, who would attempt to bring the parties into agreement. The mediator's findings would be non-binding.
  - Ultimately, after all of these steps have been taken, a contract can then be imposed by the City, but legal challenges should be expected.
  - When an entire contract is at issue, on a expedited basis this process would take at least six to nine months and could take longer. Unilateral implementation can only occur for one year. Accordingly, as soon as the process is complete for one year it would start over again for the next.

- The risk of a labor strike would be extremely high. Since IBEW represents more than 90% of DWP employees, the impacts would be very difficult to manage. There would clearly be service impacts, investments in capital infrastructure would be delayed, construction projects requiring utility installation, relocation and inspection would be delayed and significant rate uncertainty and possible volatility would result.
- The Ratepayer Advocate advises that rate cases will be coming forward within the next year and rate adjustments will be required. There are many issues which must be addressed that are not compensation and terms and conditions of employment matters that would be covered in an MOU. Efficiencies, process changes, employment level adjustments based on bench marking and improved service delivery, etc., all must occur in order to mitigate rate increases and ensure that the DWP continues to access and efficiently use capital to get "money in the ground" to meet its capital programming

needs. These are multi-year and complicated re-engineering efforts. Some, but not all, of these issues are contained in MOU footnotes and side letters that have developed over the last 30 years. The proposal before you includes language requiring the review and modification of all MOU footnotes and side letters during the term of the agreement, and those side letters which deal with compensation provisions resulting in a salary disparity with common City classes will be reviewed and modified by September 30, 2014. While it would not be appropriate for the Ratepayer Advocate to specifically recommend whether or not the City should accept a union proposal for an MOU, they advise that there is considerable risk to the ratepayers in achieving the necessary business practice changes in an environment of contentious contract negotiations and ongoing management/labor tension. The City must take this into account in determining whether the proposal before you makes sufficient progress in achieving our MOU goals.

Notwithstanding the difficult and lengthy process, the Council should be prepared to go through impasse proceedings and unilateral implementation when necessary. This office has in the past recommended declaring impasse and proceeding through the process and will continue to do so in the future when appropriate. However, the risks associated with such a strategy should only be undertaken if there is a clear path to a required result that cannot be achieved in any other way. Given the fact that the proposal meets all of the basic principles established by the Mayor and Council with regard to labor agreements, provides substantial economic benefits to the DWP that will help mitigate rate impacts on the consumer, results in substantive pension reform, provides a platform for successful negotiations with other City unions, and provides results that we do not believe can be matched in open contract negotiations, we do not believe it is the best interests of the City and the ratepayers to reject the proposal in favor of open contract negotiations.

4. How does the decision made relative to the proposal impact the bargaining environment with all of the other City labor unions with which the City will be in negotiations within the next 12 months.

The City's General Fund projected budget gaps over the next several years assume there are no COLAs for any City employees over the next three years. The IBEW proposal provides a very strong framework for the City to ensure that compensation for other City employees remains at least flat and we continue to make progress in having employees pick up a larger share of their healthcare premiums.

If there is no agreement with IBEW and contentious negotiations commence, it is unlikely that any of the City unions will agree to contracts with no COLAs and other concessions to reduce the City's costs for employee healthcare. Therefore, in order to protect the General Fund and continue our path to structural balance, without the IBEW platform to work from, the City should assume that it will be in a position of negotiating to impasse and unilateral implementation with all of the City unions at the same time.

On the other hand, if the City enters into negotiations with other City unions with the IBEW template in place we will be in a stronger position to work cooperatively with the other City unions to achieve our required outcomes to achieve structural General Fund balance and control future cost escalation. It may still be necessary to negotiate to impasse and contract implementation, but the City's starting point will be clearer and there will be a precedent in place from which to work.