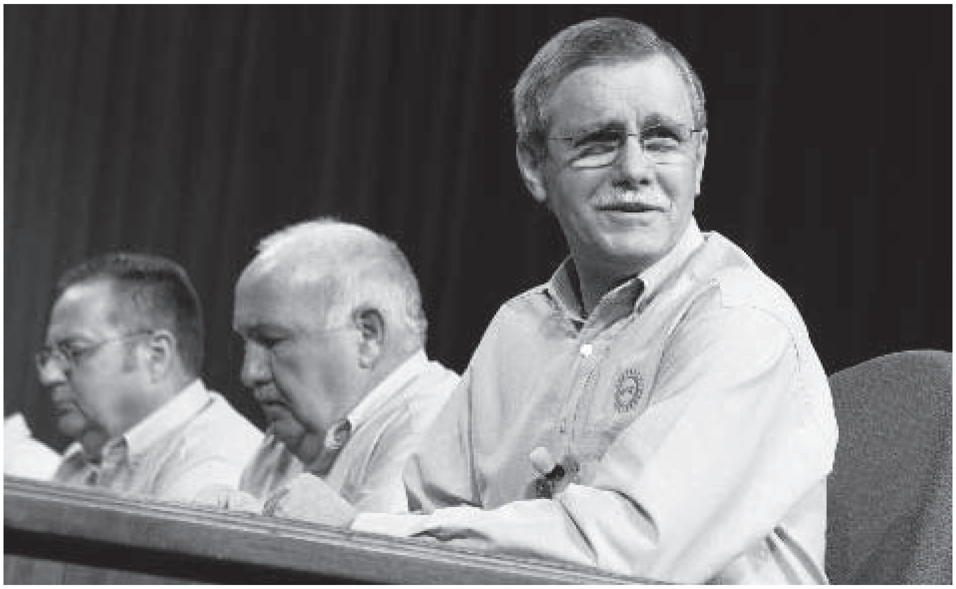
CAPITAL RESEARCH CENTER

Labor Watch

VEBAs: Union Slush Funds for the 21st Century

By Brian M. Johnson & Ryan L. Ellis

Summary: Labor unions have been searching for a revenue enhancer, something to overcome their loss of dues-paying members and increased Labor Department oversight of their financial activities. And they've found it in VEBAs, the acronym for a heretofore obscure entity called a "voluntary employee benefit association." More and more corporations may soon be giving unions control over their employee benefit trusts. These multi-billion dollar concessions are the unions' golden ticket to renewed power. Worse, Labor Department efforts to monitor union control of VEBAs is threatened by union lawsuits and adverse court decisions.



On November 12, United Auto Workers President Ron Gettelfinger (right) signed a historic labor contract with General Motors, giving UAW control over a $35 billion retiree health benefits trust.

Since the era of the New Deal, the United States has been under a cloud of federal laws and regulations that give extraordinary privileges to labor unions, endowing them with collective bargaining "rights" that are unfair to business owners and workers. Under the law, unions can coerce workers to become members and compel them to pay dues, which guarantees that union officials have a steady income stream for organizing, political activism and even personal gain.

Because their money flow is protected by federal and state laws, union officials know they can handle with impunity any pleas for accountability from their members or from the public. Unions often invest member dues in high-risk ventures to try to capitalize on high rewards, but their latest money grab takes the cake. The struggling United Auto Workers (UAW) has managed to gain control over an enormous sum of money contained in the benefits funds owed to UAW members who have retired from General Motors. Recently General Motors (GM) decided to transfer $35 billion to UAW control. The money is intended as a healthcare trust, only now the union and not the company will make the investment and management decisions concerning retiree healthcare accounts. GM's action is incredibly irresponsible: It endangers the fiscal well-being of its retirees and it hurts the public interest by thwarting the progress the Labor Department has been making in trying to more closely monitor union finances.

What are VEBAs?

Voluntary Employee Benefit Associations, or VEBAs, are a creation of the tax code, much like pension plans or nonprofit charities. They were first enacted back in 1928, when Congress almost certainly didn't envision giving a slush fund to labor unions. Contributions to VEBAs are tax-exempt and can be tax-deductible under Internal Revenue Code Section 501(c)(9). The section reads:

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

It's that last part—inuring to the benefit of any private shareholder or individual—that's really at question here. When VEBAs are controlled and managed by labor unions, notorious for their misuse of funds, their assets are at great risk, especially when oversight is inadequate or non-existent.

Under the current agreement, the United Auto Workers has been given a free hand to define "health care" under the Treasury regulations—not coincidentally written by IRS officials of Presidents Lyndon Johnson and Jimmy Carter—which implement VEBAs. The regulations define "sick and accident benefits" as:

> …amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent. Such benefits may be provided through reimbursement to a member or a member's dependents for amounts expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program. Similarly, a sick and accident benefit includes an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury. Sick benefits also include benefits designed to safeguard or improve the health of members and their dependents. Sick and accident benefits may be provided directly by an association to or on behalf of members and their dependents, or may be provided indirectly by an association through the payment of premiums or fees to an insurance company, medical clinic, or other program under which members and their dependents are entitled to medical services or to other sick and accident benefits. Sick and accident benefits may also be furnished in noncash form, such as, for example, benefits in the nature of clinical care services by visiting nurses, and transportation furnished for medical care.

You could drive a truck through that loophole. One could easily imagine the UAW requiring members to use union nurses and hospitals, or telling GM retirees that they cannot receive care from certain non-unionized companies. The union might also want to stretch out the definition of "safeguard and improve the health of members and their dependents" to, say, use funds for electing pro-union and health care reformers to political office. Stranger things have happened.

What about the "inurement" clause—the part that prohibits officers of VEBAs from benefiting from VEBA payments? The general rule on that is the following:

> No part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of benefits permitted. The disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost (including indirect costs) to the association, other than as a life, sick, accident or other permissible benefit, constitutes prohibited inurement. Generally, the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers or fiduciaries has an interest, will constitute prohibited inurement. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section. The guidelines and examples contained in this section are not an exhaustive list of the activities that may constitute prohibited inurement, or the persons to whom the association's earnings could impermissibly inure.

This is where oversight comes in. The Department of Labor under Secretary Elaine Chao has greatly strengthened the Office of Labor Management Standards (OLMS), which was previously gutted by the Clinton Administration and is now again under assault from the new Democrat majority in Congress. Roughly speaking, the OLMS is to labor what the Securities Exchange Commission (SEC) is to corporate America. Unions must disclose their finances, and bad actors can be tracked down by OLMS. One of the great areas of success has been the revamping of federal financial disclosure forms, which track the revenues, expenditures, assets and liabilities of labor unions. This disclosure has for the first time in a real way let the sun shine on Big Labor.

Financial Disclosure

When the Labor-Management Reporting and Disclosure Act (LMRDA) became law in 1959, the U.S. Department of Labor was made responsible for the task of ensuring that unions are held to basic standards of democracy and financial responsibility. Eventually, in 1984, the agency in charge of this task became officially known as the Office of Labor Management Standards. OLMS enforces standards of financial integrity by monitoring union fiscal disclosure reports that are filed using such forms as the LM-2, the LM-3 and the LM-4. To date, OLMS has convicted more than 780 union officials on charges ranging from corruption to embezzlement and

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has restored $110 million in dues to union members.

These reforms have been implemented at a time when private sector union membership is on the decline: private sector union density has plummeted from more than 30 percent in the 1970s to slightly more than seven percent today. As a result, union bosses are becoming more and more ferocious in trying to draw in and retain a steady stream of dues. The OLMS, through its diligent pursuit of union corruption, is a dam in the free-money river that for almost 30 years flowed unchecked directly into union coffers.

GM's transfer of its retirees' benefits trust fund to the UAW has put a new burden on the Labor Department. And the courts are preventing the Labor Department from doing its job of preventing corruption.

Based on their size and revenues, unions are required to submit specific LM forms to OLMS, which monitors the union's financial activities and ensures its fiscal accountability. These forms are necessary tools to catch, prosecute and convict corrupt union officials who control member funds. But GM's transfer of its retirees' benefits trust fund to the UAW has put a new burden on the Labor Department. And the courts are preventing the Labor Department from doing its job. If GM's concession is repeated elsewhere and sets a precedent in how corporations deal with union VEBAs, then the job of monitoring union finances and making union officials accountable will become even more difficult.

From 2001 to 2006 the OLMS budget increased 50 percent, which allowed the agency to hire more personnel, which led to a 26 percent increase in convictions of corrupt union officials even as the overall pool of union members was shrinking. Less members, more corruption—that's the apparent trend facing OLMS investigators.

The LM-2 is the most detailed of the forms. Revised in 2003 to combat union financial corruption and break down million-dollar line items into more detailed figures, the revised LM-2 has dramatically increased union accountability and fiscal transparency. The LM-2 contains requests for 21 items of information and 47 financial matters and it has 20 supporting schedules that must be completed and filed by unions with total annual receipts of $250,000 or more ($200,000 or more for fiscal years beginning before July 1, 2004). Unions in trusteeship must also file LM-2 forms.

The LM-3 is less detailed than the LM-2 and may be filed by unions with total annual receipts of less than $250,000 (less than $200,000 for fiscal years beginning before July 1, 2004) if not in trusteeship. Form LM-3 requires the completion of 23 information and 32 financial items.

The least detailed report in the series is the LM-4. This abbreviated annual report may be filed by unions with less than $10,000 in total annual receipts if they are not in trusteeship. Because of the small number of receipts, the LM-4 only requires completion of 13 information and 5 financial items.

The Department of Labor should be congratulated for revising the LM forms and heightening OLMS scrutiny. Its actions have greatly increased the transparency of union finances. But one thing is missing: The public disclosure of information on union trust funds and pension management. The Labor Department tried to address this problem when it created Form T-1, which would have been the last piece in the transparency puzzle. However, in 2004 the AFL-CIO counter-attacked. It sued the Department of Labor to invalidate the form, and it won.

The upshot: Unions can now operate VEBA's, multiemployer pension plans, and comparable pots of trust fund money with no public disclosure.

Trust Reporting

The T-1 form was the crux of the Labor Department plan to have labor unions disclose the finances of trusts they control. For fiscal years beginning on or after January 1, 2007, a labor organization with total annual receipts of $250,000 or more would have been required to file Form T-1 for each trust in which it has an interest. If the union's financial contribution to the trust (or a contribution made on the union's behalf, or as a result of a negotiated agreement to which the union is a party) was $10,000 or more during the reporting year, and the trust had $250,000 or more in annual receipts, then the Labor Department also would have required a T-1 filing. A "trust" in which a labor organization has an "interest" is a fund or organization (1) which was established by a labor organization or one of its trust designees, (2) a primary purpose of which is to provide benefits for the members of the labor organization or their beneficiaries.

According to Secretary Chao, the T-1 report was "necessary to discourage circumvention or evasion of the reporting requirements… and would impose minimal burden." But the AFL-CIO had a different opinion and sued to block the form. The D.C. appeals court ruled against Secretary Chao, stating that her request to implement the T-1 form "exceeded her authority by requiring general trust reporting." The ruling is a major set-back to OLMS efforts to make unions financially accountable.

Secretary Chao's attempt to require unions to report on the condition of financial assets contained in trusts they control seems clearly justified under the LMRDA. The law states:

Every labor organization shall file annually with the Secretary a financial report signed by its president and treasurer or corresponding principal officers containing the following information in such detail as may be necessary to accurately disclose its financial condition and operations for its preceding fiscal year – (1) assets and liabilities at the beginning and end of the fiscal year. (LMRDA 29 U.S.C. §§ 201(b))

Trusts are assets! But Big Labor saw a

chance to capitalize on trust acquisition and acquire a rushing torrent of new unreported, undisclosed money.

Multiemployer Pension Plans

Remember the parable about the three servants given a sum of money to invest while their master is away? The first servant handled his money like a no-interest checking account; he didn't do too well. The second sought the equivalent of a high-yield savings account and did a bit better. But the third invested in a stock index fund and did best of all. The lesson is, "To whom much is given, much is expected." Can unions be expected to handle their members' money as wisely as the third servant?

Back in the bad old days of industrial America, defined benefit pensions ruled the roost. According to the Employee Benefits Research Institute (EBRI), 84 percent of workers at large firms participated in a defined benefit pension plan in 1980. By 2003, that number had declined to 33 percent and it's been falling ever since. There are many reasons for this remarkable change but surely one important one is that America has a much more mobile workforce. Employees who cannot vest quickly enough in defined benefit pension programs recognize the greater benefits of a 401(k)-style "defined contribution" plan. Employees are always 100 percent vested in their own salary deferrals, and an employer's matching contribution to a defined contribution plan tends to vest more quickly than in a defined benefit plan. Moreover, defined contributions plans are portable. The employee can rollover the plan's assets into the 401(k) of a subsequent employer or into an Individual Retirement Account (IRA).

The rise of defined contribution pension plans has put great sums of money beyond the reach of labor unions. Even so, the defined benefit pension funds that remain contain enormous assets that have grown in size, from $814 billion in 1985 to $1.937 trillion in 2004. The unions have their eye on this money.

In industries where multiple employers are governed by a single collective bargaining agreement, unions have sought to establish "multi-employer" defined benefit pensions. In theory, these arrangements make good actuarial sense, since payments and risk are spread across a wide pool of employers and workers. However, in practice the boards of trustees who have a fiduciary obligation to administer the pensions plans are susceptible to the worst kinds of political gamesmanship.

Unions that have acquired a management say over massive amounts of pension assets have tried to bully their way onto corporate boards. They have threatened to retaliate against companies that don't allow easy unionization. And they have tried to influence how companies participate in the political process. CalPERS, the administrators of the defined benefit pension plan that covers 1.5 million California government employees and retirees, even has a dedicated website (www.calpers-governance.org) explaining how it invests its pension assets to affect corporate policies and advising other shareholder activists how to use their power to influence "corporate governance.".

GM/UAW VEBA Agreement

On September 26, following a three-day union strike, GM and the UAW reached a landmark agreement and the strike ended. What made the agreement a landmark was the concession GM made to the union concerning the treatment of its pension fund. A provision in the new contract creates a VEBA trust that GM will fund. But the trust will be controlled by the UAW. GM will transfer $35 billion to the new union-controlled VEBA in return for taking about $50 billion in pension liability off its books. The agreement helps GM by allowing it to shake off its own responsibility for the pension shortfall it created.

As for Big Labor, if it is looking for something to make unions once again relevant to workers, union control over their pensions is it. VEBA is the answer. And because the union doesn't have to file a T-1 form making it publicly accountable for the trusts it controls, VEBA is a union boss's salvation.

It's been reported that the four-year labor contract between the UAW and GM provides that the new VEBA will contain a $4.4 billion note convertible into GM shares. If the UAW converted this bond into GM stock, the union would hold a 17 percent equity stake in the company (based on its present market value of $21 billion). This means that the UAW, which was just on strike against GM, can now vote its shares to affect the company's management decisions.

This striking turn of events has a significance that cannot be over-emphasized. The great achievement of the 1947 Taft-Hartley Act permitting states to enact Right-to-Work laws was that it gave the states the authority to end unions' power to force workers to join a union. However, that authority has been impeded by union political pressures, personal intimidation and physical violence. The new GM-UAW agreement has created a business model of potentially extraordinary power and flexibility. It gives the union a vested interest in the corporation by giving it shareholder ownership stake in the company, and it does this by creating a financial trust whose assets come from the corporation and are intended for the workers' benefit—but are controlled by the union's officials.

The UAW immediately recognized the significance of the agreement. It told the *Financial Times* that "it [the UAW] will use the GM deal as a pattern to negotiate contracts with Ford Motor and Chrysler." That is exactly what has happened, and now the UAW has influence over those companies as well. This slippery slope is only too real, and union officials see it as their way to regain 1950s-style control over labor markets, ensuring jobs for union members at the expense of the majority non-union public.

Clearly, giving unions money to exploit the shortsightedness of corporate America is not a sound strategy. The likelihood is that sooner or later the UAW will invest its VEBA assets only in companies that toe the UAW organizing and political line. Along the way, there will be consulting fees, board membership fees and other investment transaction costs that will enable VEBA money to find its way into UAW coffers. No doubt the UAW hopes the combination of more money and less OLMS oversight will halt the decline in union membership, or at least replenish the union's treasury.

What's Past is Prologue

What's to be expected from giving the UAW $35 billion to manage healthcare trusts for retirees' pensions? Having forgotten the past, it's likely we are condemned to repeat it. According to the *Wall Street Journal*, "All this [the UAW/GM VEBA deal] already sounds like a replay of the 1998 Caterpillar health-care trust, albeit with bigger numbers. Containing just $32.3 million, that trust was set up by the UAW to pay the additional premium so employees could continue to receive more gold-plated coverage than Caterpillar's own premium cap would permit. Result: The money ran out in six years and now the union is suing Caterpillar."

The Caterpillar/UAW VEBA, with $30 million, came up short after six years. The GM/UAW VEBA has $35 billion (that's billion with a "b"). Whatever happens, it seems that shifting corporate accountability has trumped employee protection yet again, only this time it's the unions that are responsible for the workers' pensions. And it's the OLMS that under current law has no authority to monitor their investments.

If the past is any indicator of the lifespan of union-managed pensions, GM workers may want to start saving. As illustrated by the Caterpillar situation, VEBA projections can be very wrong. Our own preliminary projections for the GM/UAW VEBA, using conservative healthcare estimates and allowing for a generous investor climate through 2047, indicate the VEBA has a lifespan of 10 to 15 years at most.

What's to be done? A smart administrator might use the VEBA money to fund health savings accounts (HSAs) for every eligible employee and retiree. Give families a health insurance plan with a deductible of (say) $2,400, and individuals $1,200, and cover preventive care before the deductible kicks in. The VEBA would pay for the insurance premiums and up to $5,800 of HSA contributions ($2,900 for individuals). Unlike the current underfunded VEBA mess, this defined contribution solution would permanently secure sustainable healthcare for all 550,000 GM workers and retirees.

Currently Secretary Chao is fighting for union-trust fund accountability and hopes to develop a new T-1 Form that will survive court scrutiny. Unfortunately, the GM/UAW model has already caught on. Other corporations are making plans to transfer their pension liabilities to union-controlled VEBA accounts, sometimes without even waiting for a union request. They see it as a "get out of jail free" card. For the unions it's a "golden egg."

Of course, the real losers are workers whose pensions are in jeopardy. If Congress dismantles the only agency that monitors union financial activity and if the courts invalidate a new T-1 Form, workers will have lost essential checks on union corruption and malfeasance.

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Labor Notes

Unions Cozy With Democrat Presidential Candidates

Labor unions have long favored Democrats over Republicans, but this year UPI reports that all of the candidates seeking the Democratic nomination are even more aggressive than usual in appealing for union support. Harold Schaitberger, president of the International Association of Fire Fighters, told *The Christian Science Monitor* that candidates are "open, aggressive, and comfortable talking about and embracing the labor movement." The AFL-CIO is responding with a pledge of $53 million in 2008 get-out-the-vote efforts but has avoided a national endorsement. The Communications Workers of America and other national unions also have decided against endorsing any particular candidate, instead leaving the decision to locals because of disagreement about the best candidate.

Union Members Ignore Union Endorsements

Among unions that have endorsed presidential candidates, former Sen. John Edwards has had relative success—but union members are not following their leaders. November Gallup Polls show Sen. Hillary Clinton with 45 percent support among union members, nearly identical to her 46 percent support among non-union voters. Sen. Barack Obama (19 percent) and Edwards (17 percent) lag far behind among union members. Although they prefer Democrats, union members are favorable to Republicans; only former Massachusetts Mitt Romney is viewed more negatively than positively by union members. Fewer than two-thirds of union members identify as or lean Democrat.

Congressional Democrats Split With Unions on Key Issues

Democratic leaders in Congress are having a difficult time toeing the union line on some issues of key importance to Democratic voters. Even while Sen. Barbara Boxer is struggling to find party unity on a bill to address global warming, the AFL-CIO is complaining that the proposed draft imposes obligations on American manufacturers without treating foreign companies equally, until eight years after the effective date of the legislation. Unions are concerned that the bill could affect domestic manufacturing jobs. Senate leaders found even stiffer opposition from Big Labor when they announced nominees to fill two key posts at the Securities and Exchange Commission (SEC), passing over union favorite Damon Silvers, an AFL-CIO attorney. Arguing for tighter business regulation, unions oppose Democratic nominee Luis Aguilar, an attorney who has represented large investment firms and has expressed doubts about the effectiveness of the 2002 Sarbanes-Oxley law to address corporate scandals.

AFL-CIO's Sweeney Seeks Corporate Regulation on Child Labor

More blame must be placed on American corporations for violation of child labor laws overseas, AFL-CIO President John Sweeney told *The Washington Times* in a November 16 interview. He called for additional efforts to link trade and child labor issues during free trade negotiations, as "one way of raising the resources that are necessary for the kind of enforcement that's necessary." Sweeney was attending the recent International Labor Organization (ILO) conference on globalization and child labor in Lisbon; for more on the ILO, see last month's *Labor Watch* at www.capitalresearch.org.

Unions Fight Florida Tax-Cut Referendum

Although Florida's upcoming January referendum on overhauling state property taxes was carefully designed to appeal to voters, labor unions' strong opposition has some concerned that it will not receive the 60 percent approval that it needs. "You look at the kind of money people are going to get back—and it's not worth the cuts in services they'll face," said Bob Carver, president of the Florida Professional Firefighters Association, to the Orlando Sentinel. The average Florida homeowner would save $240 next year if the plan is approved. The AFL-CIO and member unions instead want the $9.6 billion over the next five years for county and local programs.