

Testimony to the Michigan House of Representatives Public Employee Health Care Reform Committee

Kate Kohn-Parrott, December 15, 2009

Good afternoon, Madam Chair and distinguished Committee members.

I appreciate the opportunity to once again address this committee regarding House Bill 5345 that seeks to consolidate the planning, administration and delivery of health benefit programs for Michigan's public sector employees and retirees.

Over the past couple of months we have heard from a number of parties with varied opinions on this topic and this bill. Today, I intend to revisit how this proposal was ideated and certain sections of the bill. I will also comment on some of the testimony that has been presented to this committee.

House Speaker Andy Dillon first talked to me in May about the idea of consolidating the health care benefits for Michigan's public sector. In light of projections for continued declines in state revenues, the Speaker wanted to explore this as a pathway to help address some of the state's financial issues. He was particularly interested in finding a way to help keep teachers in the classroom and police on the streets; basically to preserve jobs while continuing to offer high-quality health benefits to the state's public employees.

The rationale behind this proposal is quite simple, and it is to reduce the number of dollars currently spent on health care benefits for the state's public employees and to share those savings with the state's public employers. This will be done by

- identifying and eliminating areas of administrative duplication and waste
- streamlining and improving administrative processes
- leveraging the size and scale of the state's public sector to ensure cost effective purchasing, and
- developing an employer-based health care program with the size and clout to reward compliance with evidenced-based standards of medical care and focus on employee health and wellness

Certainly the suggestion to consolidate public employee health benefits is not a new idea. Several studies have been conducted over the past several years illustrating the financial benefits from following this approach. Just this year, various business and taxpayer groups have published lists of ways that the state can address its perennial budget issues, and the consolidation of public employee benefit programs has shown up repeatedly on such lists.

In July, the first white paper on this proposal was published. It is important that we all remember that the first white paper was clearly noted “Draft and Preliminary,” which is exactly what that first paper represented – an early draft of the proposal. This is an important point as a second white paper that was published in September updated and superseded parts the original white paper. For example, the first white paper referred to one plan even though there was never any intention that public employees would have access to a single benefit plan design; it was always envisioned that an array of multiple benefit plan designs would be made available to the state’s public sector. The choice of the word “plan” in the first white paper was unfortunate as it really meant “program.” It is also unfortunate that some of the testimony presented to this committee and some of the public attacks to this proposal have continued to reference the original white paper.

The process of vetting the Speaker’s proposal was always intended to be collaborative and inclusive. Therefore, shortly after the first white paper was published, an email request was sent to at least 25 potentially interested parties asking for written ideas, suggestions and assistance with the proposal as well as in defining the next steps. Only six formal replies were received, and some of the input received was used in drafting Bill 5345. And, some of that input was also included in the second white paper.

I will now briefly discuss some of the opportunities that this proposal presents to reduce the costs of health benefits in the state’s public sector.

The first opportunity falls under the category of administrative savings. To fully understand how administrative savings are possible, one must understand the types of administrative costs that are incurred in managing and delivering health benefits; unfortunately, many of these costs are included in the premium cost for health benefits and are therefore not transparent. Far too often, administrative costs are viewed only as an employer's internal costs of administering benefit programs. And, while, yes, this is a form of administrative cost, it is generally less than the other types of administrative costs, which include:

- Dollars paid to health plans, insurance carriers and third-party administrators for administrative services associated with account management and adjudication of claims;
- Access fees paid to health plans or third-party administrators to use their provider networks;
- Fees paid to brokers and insurance agents – they are not doing this work for free, and yet, many employers do not understand how much they are paying for these services; and
- Fees paid to consultants

Please note that while these are necessary costs of doing business, these are the type of administrative costs—not the employer's internal staff costs—that can be addressed and reduced through consolidation.

Administrative costs will not go away, but they will be lower. A recent report suggested that under this proposal, administrative costs could be about 7% of total premiums. This is a reasonable suggestion and it's actually good news. Generally, administrative costs across the United States average 12.2% for all entities and range from 7% of total premiums for large employers to 26% for small employers. While we are working to get specific cost data from the state's public employers, it is likely that their administrative costs currently average more than 7%; therefore, savings will be generated as administrative costs decrease.

We have heard testimony that questions the opportunity to leverage a larger purchasing pool to achieve economies of scale. Some have said that such opportunities do not exist because health care pooling already exists in

Michigan's public sector, and others have said that the value of pooling maxes out at 20,000 members.

Yes, there are purchasing pools in Michigan and yes they have been successful in helping to contain health benefit costs. But additional opportunities remain, including:

- Pooling those employers that are not already pooled;
- Increasing the size of existing pools;
- Buying certain medical services, such as prescription drugs, more effectively;
- Taking maximum advantage of all existing cost-effective purchasing practices;
- Adopting self-insured coverage where appropriate; and
- Looking into pooling opportunities in dental, vision, life and disability.

It is also important to note that the benefits of pooling come primarily from purchasing pooling, which is not the same as risk pooling. While risk pooling will deliver benefits to those public employers who are not currently pooled or who are in small pools, the value of risk pooling does max out when the demographics of the pool emulate the general population. That may indeed be at 20,000 individuals.

However, the value of purchasing pooling extends well beyond 20,000 individuals. From 2004 through 2008, I was responsible for directing all aspects of Chrysler's benefit programs, including the negotiation and purchasing of benefits for 350,000 covered lives. I know that I paid less for certain benefits than my counterparts at smaller companies while I paid more than my counterparts at larger companies—and both of these circumstances were the direct result of the size of my purchasing pool.

I distinctly recall negotiating terms of a contract for about 300,000 individuals and being told by the supplier that if the number of covered individuals fell by 10% then my costs would go up far more than 10%. Yes, I said a drop of 10%, or

30,000 people, on a pool of 300,000, which clearly demonstrates the power of size and scale in purchasing pooling.

While there are substantial savings opportunities in administrative costs as well as through leveraging an increased purchasing pool, most of the opportunities to save money come from more efficient oversight of health benefit programs. This committee has heard from a number of experts on how such savings may be realized.

I personally found the testimony from Mr. Keith Bruhnsen to be most compelling. Mr. Bruhnsen talked about the real savings that have been achieved by the University of Michigan through aggressive changes in the way that U-M manages their prescription drug programs and how they have been able to pass those savings on to their employees.

A more aggressive approach to managing prescription drug programs can deliver the single biggest area of savings. The second white paper estimates savings of 5-10 percent on the purchase of prescription drugs. In the Q&A, Mr. Bruhnsen said that the level of savings projected in the white paper was easily do-able and that even greater savings were possible. In the second white paper, it is estimated that the state's public employers spend about \$1 billion per year to cover prescription drug benefits. This assumed that prescription drugs make up about 20% of total health benefit costs.

Using the estimate of \$1 billion in prescription drug costs, savings of 5 to 10% would range from \$50 to \$100 million. Yet, information recently received from the DMB shows that the state's civil service spends about 34% of total health benefit costs for prescription drugs for active employees and more than 42% for retired employees. This means that the total spent on prescription drugs is likely more than the \$1 billion estimate, and it further means that absolute dollars saved would increase.

The autos introduced over the last few years a number of initiatives to more efficiently manage prescription drug programs, saving hundreds of millions of

dollars in total. There is no reason that the state cannot adopt similar programs that will also generate outstanding cost reductions.

There have been allegations that the only possible way to save money from this program is from cutting benefits and/or shifting cost to employees. Some have contended that if it costs less, it is less. That's not so, and real savings are possible by including a number of important plan elements in the design of employee benefit programs, without shifting cost to employees or taking away their health benefits. For example, more effective wellness and prevention programs, the use of clinical advocates, adoption of value-based insurance design and evidenced-based health care, changing the way providers are reimbursed to shift their focus to more comprehensive care, the use of incentives to encourage healthy behaviors and addressing fraud in the system.

Regarding the use of clinical advocates, it is truly unfortunate that this topic has drawn such a negative response. Clinical advocates, as Evan Falchuk testified, work only for the patient and only at his/her request, providing peace of mind and a sense of security that the patient diagnosis and treatment plan are appropriate. The patient then chooses whether to accept or reject the clinical advocates' recommended treatment plan-it is not mandatory. Real experience demonstrates the value of clinical advocates in getting the right treatment to patients in a timelier manner with documented improvements in patient safety and care.

There are a variety of other ways that the MI Health Benefits Program can contribute to lower costs. While I do not suggest that the American Federation of Teachers – Michigan and the International Union of Operating Engineers Local 547 endorse this proposal, they did issue a report in 2005 that recognized the opportunity to save up to \$233 million per year in Michigan's public education employee health care costs in part through transparent health care cost information, disclosure of hospital and physician performance on measures of quality, state-of-the art programs to improve member health, and efficient administrative services that leverage industry standards and information

technology within a competitive environment. The MI Health Benefits Program should take a voice in driving this type of system change.

There has also been quite a deal of commentary on the topics of collective bargaining and the bill's "opt-out" provision. There is no question that for some the bill does change elements of collective bargaining—particularly in terms of benefit plan design, but it is not correct that the bill eliminates collective bargaining. Numerous hours were spent developing a governance board that preserves a union voice throughout the process, with four labor representatives and one retiree representative directly at the table. It would not be practical to keep a seat at the table for every individual labor representative, however, it should be expected that labor groups and representatives define a process where they are involved in setting objectives and deliverables.

Specifically at the local level, the bill preserves collective bargaining for each local bargaining unit over the choice of health plans to be offered to employees, premium share, and eligibility.

While not specific to the bill, a question that is often asked is why doesn't the state wait to see what happens with health care at the federal level. In answer to that question, the federal plan is focused to a great extent on getting coverage for the UN and underinsured and also on making sure that small employers are able to provide health benefits to their employees. The MI Health Benefits Program is an employer-based program. The federal plan will retain employer-based health care while expecting employers to provide and pay for health benefits for their employees.

The creation of this committee, the public testimony and now the formation of the work groups are all natural progressions in an iterative, process that encourages collaboration and participation.

Thanks for your time and attention.

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December 9, 2009

Honorable Pam Byrnes, Chair
House Committee on Public Employee Health
Care Reform
Room 251, Capitol Building
Lansing, MI 48933

Honorable Members of the House Committee
on Public Employee Health Care Reform
Room 251, Capitol Building
Lansing, MI 48933

Re: House Bill 5345 of 2009 and Michigan Constitution 1963, Article XI, Sec. 5.

Dear Chair Byrnes and Members of the Committee:

The International Union, UAW has authorized me to share with you the attached internal legal memorandum containing my analysis and concluding opinion that House Bill 5345 is unconstitutional with respect to its application to Michigan's classified service.

The memorandum specifically addresses the line drawn between the Civil Service Commission's constitutional authority to set compensation for the classified service and the Legislature's constitutional authority to appropriate funds and regulate the public health.

Based on the Michigan court and Michigan Attorney General opinions cited and discussed in the memorandum, it must be concluded that health care benefits are "compensation" and the Legislature would infringe on the Civil Service Commission's constitutional authority to "fix" classified employees' "rates of compensation" by passing legislation that would directly or indirectly regulate classified employee health benefits.

I hope you find this legal memorandum useful as you deliberate on this bill. Please feel free to contact me if you have any questions.

Sincerely,

Georgi-Ann Bargamian
Associate General Counsel

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enclosure

Chair Byrnes and Members of the Committee

December 9, 2009

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cc: Rich Atwood
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Inter-Office Communication

September 25, 2009

To: Several

From: Georgi-Ann Bargamian

Subject: ***Dillon Health Care Pooling Legislation –
Applicability to Michigan Classified Service***

On September 10, 2009, Michigan House Speaker Andy Dillon introduced House Bill No. 5345 “to provide for consolidation of health benefits for public employees” and set up mechanisms to administer that “consolidation.” “Draft A” of the bill is pending at the House Committee on Public Employee Health Care Reform.

The bill does not exempt Michigan classified employees. Their inclusion raised questions about the bill’s constitutionality because Article 11, Section 5 of the Michigan Constitution gives the Michigan Civil Service Commission plenary authority over the classified service’s “compensation” and other terms and conditions of employment.

I was asked to assess the bill’s constitutionality with respect to its application to the classified service. It is my opinion that Dillon’s health care pooling bill is unconstitutional to the extent that the Legislature attempts to establish classified service “compensation” by requiring state classified employees to be part of a public employee health care benefit pool. Health care is a core component of “compensation” as that term has been defined in Michigan Attorney General and court opinions and only the Civil Service Commission can set compensation terms generally and health care terms specifically.

The Michigan Constitution’s Article 11, Section 5

Article 11, Section 5 of the Michigan Constitution establishes the Civil Service Commission’s authority over the classified service. It states, in relevant part:

The commission shall . . . fix rates of compensation for all classes of positions . . . and regulate all conditions of employment in the classified service.

It is well established that this constitutional provision gives the Civil Service Commission “plenary powers in its sphere of authority.” *Plec v. Liquor Control Commission*, 322 Mich. 691 (1948). That “sphere of authority” includes establishing “compensation.” As such, “even the Legislature is without power to regulate the internal procedures” of the Civil Service Commission. Mich. Const. Art. 4, §48 (Legislature “may enact laws providing for the resolution of disputes concerning public employees, except those in the state classified service”); *Viculin v. Dep’t of Civil Service*, 386 Mich. 375 (1971). Rather, the Civil Service Commission has “broad . . . constitutional authority to regulate

the compensation and working conditions of classified state employees.” *Crider v. Michigan*, 110 Mich. App. 702, 716 (1981).

Michigan Attorney General opinions specify that “compensation” in Article 11, Section 5 “is a general term incorporating within its meaning not only salaries but also fringe benefits” OAG No. 4732 (December 29, 1971). The Attorney General has determined that pensions, group life insurance, and “hospital-medical-surgical benefits for employees in the state classified service” are all forms of “compensation.” *Id.*; OAG No. 3414 (October 12, 1959). In his 1959 opinion determining the Civil Service Commission’s authority to provide for pensions, group life insurance and medical insurance, the Attorney General observed:

The Michigan civil service commission in its rules recognizes that in some instances, there may be some remuneration for service of state employees in a form other than money. . . . The constitution does not designate that the medium of compensation must be solely in the form of money; therefore, it is within the discretion of the civil service commission to provide within reasonable limits that a portion of the compensation be in some other form.

The above two Attorney General opinions rely in part on Michigan Supreme Court cases, including one case which ruled that “compensation” goes well beyond simple “wages.” *See, e.g. Kane v. City of Flint*, 342 Mich. 74 (1955) (holding that pensions, insurance premiums, and uniforms are “compensation”).

The Legislature’s Authority vs. the Civil Service Commission’s Authority

While only the Civil Service Commission has authority to establish and regulate the classified service’s “employment-related activity involving internal matters,”¹ the Legislature has general constitutional authority to appropriate funds² and particular constitutional authority to regulate the public health.³

With regard to its power of the purse, the Legislature controls appropriation of funds to State departments and political subdivisions, including the Civil Service Commission and the State’s constitutionally established research universities. However, the Legislature’s appropriation power does not permit it to “attach unconstitutional conditions” and direct the Civil Service Commission’s or the state research universities’ internal spending allocations. *Civil Service Commission v. Auditor General*, 302 Mich. 536 (1942), *quoting State Board of Agriculture v. Auditor General*, 226 Mich. 417, 425 (1924) (opinion of Justice McDonald) (“[I]n saying that the Legislature can

¹ *Traverse City School Dist. v. Attorney General*, 384 Mich. 390, 406-07 (1971).

² Const. art. 4, §31.

³ Const. art. 4, §52.

attach to an appropriation any condition which it may deem expedient and wise, the court had in mind only such a condition as the Legislature had power to make. It did not mean that a condition could be imposed that would be an invasion of the constitutional rights and powers of the governing board”).

Under its constitutional authority to make laws protecting the public health, the Legislature has passed general public health laws which Michigan courts or the Attorney General have ruled also apply to the classified service – despite the Civil Service Commission’s authority – such as the Michigan Occupational Safety and Health Act (MIOSHA)⁴, disability compensation for certain injured classified employees⁵, and requiring licensing of classified employees who hold themselves out to the public as “licensed” or “professional” counselors⁶.

Courts have upheld the Legislature’s authority to regulate public health and apply those public health laws to the classified service because they have determined that workplace safety and disability compensation are not “compensation” as used in Article 11, Section 5 or because these laws apply to all Michigan employees, or both.

Drawing the Line between the Civil Service Commission’s Authority and the Legislature’s Authority over the Classified Service

It is sometimes difficult to predict when a court or the Attorney General will rule against or in favor of legislative action impacting the classified service.

For example, the Attorney General has decided that the Legislature is not authorized to extend the protections of the Whistleblower Protection Act to the classified service because such authority is within the Civil Service Commission’s constitutional domain.⁷ At the same time, the Attorney General has ruled that the Legislature is constitutionally authorized to pass campaign finance laws to prohibit classified employee voluntary campaign contributions contrary to the Civil Service Commission’s inclination to permit such voluntary contributions.⁸

Nevertheless, there can be little doubt that the Legislature is not authorized to regulate classified employee “compensation” or “conditions of employment.” And health care benefits are “compensation,” without a doubt.⁹

⁴ *Dep’t of Transportation v. Brown*, 153 Mich. App. 773 (1986).

⁵ *MSEA v. Dep’t of Corrections*, 172 Mich. App. 155 (1988); *Oakley v. Dep’t of Mental Health et al.*, 136 Mich. App. 58 (1984).

⁶ OAG No. 6677 (March 20, 1991).

⁷ OAG No. 5736 (July 10, 1980).

⁸ OAG No. 7187 (February 16, 2006), on appeal before the Michigan Supreme Court, *MEA v. Secretary of State*, 483 Mich. 1001 (2009).

⁹ It would seem that the Legislature’s establishment and regulation of classified employee retirement benefits would violate the Civil Service Commission’s constitutional authority over “compensation,” which

Conclusion

Based on the foregoing, it is my opinion that the Legislature cannot legally include state classified employees in the Dillon health care pool bill. Apparently, others within the legislative process must think so too because the existing Public Employees Health Benefit Act, 2007 PA 106, MCLA §§124.71-.85 – which would be repealed upon passage of the Dillon plan – originally included, then excluded, the classified service.

I hope this information helps. Please let me know if you have any questions or need more information.

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includes pensions. However, the Attorney General has clarified that the Civil Service Commission has the authority to implement a supplemental retirement plan if it wants under its constitutional authority because “[t]he fact that the civil service commission has not seen fit to exercise its power to adopt a retirement program since its inception would not, of course, serve as a basis for denying that it has this power.” OAG. No. 4732 (December 29, 1971). Further, the Legislature’s establishment of the state employee pension system predated passage of the 1963 Michigan Constitution which included the Civil Service Commission’s constitutional authority over “compensation,” therefore, “it is unthinkable that the framers intended to nullify the legislatively established state employee retirement system.” *Id.* The Attorney General has concluded that statutory and Civil Service retirement programs could coexist and the Legislature could “transfer the entire state classified employees retirement program to the civil service commission” by passing a law to that effect if desired. *Id.*