In re:

CITY OF STOCKTON, CALIFORNIA,

Debtor.

ASSOCIATION OF RETIRED EMPLOYEES OF THE CITY OF STOCKTON, a nonprofit California corporation, SHELLEY GREEN, PATRICIA HERNANDEZ, REED HOGAN, GLENN E. MATTHEWS, PATRICK L. SAMSELL, ALFRED J. SIEBEL, BRENDA JO TUBBS, TERI WILLIAMS, on Behalf of Themselves and Others Similarly Situated,

Plaintiffs,

vs.

CITY OF STOCKTON, CALIFORNIA,

Defendant.

DECLARATION OF DWANE NEIL MILNES

Case No. 12-32118

Adv. No. _________
I, Dwane Neil Milnes, declare:

1. I have personal knowledge of the facts set forth in this declaration and, if called as a witness, I could and would testify competently to these facts under oath.

2. I was City Manager of the City of Stockton from October 8, 1991 to April 30, 2001. I am presently employed by Citygate Associates as a consultant with the title of General Government Principal.

3. As part of my position as City Manager, I was responsible for preparing recommendations to the City Council regarding terms and conditions of employment to be included in Memoranda of Understanding with employee labor groups representing employees of the City of Stockton. My responsibilities also included presenting these recommendations to the City Council in both closed and open session. I explained the cost and operational implications of changes in the terms and conditions of employment that would be different from those contained in the MOUs that were being renegotiated. The City Council gave me direction regarding terms and conditions of employment acceptable to the City Council in Memoranda of Understanding between the City of Stockton and the officially recognized labor groups. Terms and conditions of employment that were described to the City Council included health benefits for both employees and current and future retirees of the City of Stockton. While serving as City Manager, I was responsible for supervising and advising the City’s lead labor negotiator who met with the representatives of the labor groups to negotiate the terms and conditions of employment to be contained in the MOUs. Periodically, following labor negotiation sessions, the City’s lead labor negotiator and I reported to the City Council in closed session the response to the City’s offered terms and conditions of employment, and the requested changes in those terms and conditions made by the labor representatives.

4. Once agreement had been reached between the City Manager, the City’s lead labor negotiator and employee representatives on the terms and conditions of employment in the Memorandum of Understanding, and the terms and conditions had been approved by an employee vote, I was responsible for scheduling each Memorandum of Understanding for consideration and approval by the City Council on a Council Agenda in open session.
5. Based on my experience as City Manager, I understand that a Memorandum of Understanding with a recognized labor group is a binding contract between the City and the employees covered by that Memorandum of Understanding, once approved by the City Council and by a vote of the employees represented by the labor group.

6. I also understand that once an employee has retired with entitlements to specific health benefits, including the cost for co-pay for those benefits to the employee, that these specific health benefits cannot be changed by the City without approval of the retiree, except to increase the benefits.

7. In 1992, I discussed with the City Attorney of Stockton at that time, R. Thomas Harris, whether the City could change the benefits of retirees who were receiving health benefits from the City as specified in the Memorandum of Understanding in force at the time of their retirement. The City Attorney affirmed my understanding that the right to the benefits was vested and the City could not change the level of medical benefits for those who had already retired. He stated that if the City were to implement a medical plan with benefits at a lower level than those of the retirees, then the City would need to establish a Modified Medical Plan applicable only to current employees and future retirees.

8. Effective in 1993, the City established a Modified Medical Plan with medical benefits for employees and retirees that were different from the benefits to which those who had already retired were entitled.

9. As City Manager, I reviewed and approved the Modified Medical Plan in 1992. I then presented it to the City Council for its approval in closed session as part of changes to the terms and conditions of employment in the Memorandums of Understanding that the City was then negotiating with labor groups representing the employees.

10. Section 6.17 of the Modified Medical Plan was written by me and included at my direction. I directed that Section 6.17 be included in the Modified Medical Plan document to be presented to the City Council solely for the purpose of providing the City with the right to change third party administrators of the medical plan or to add or change medical plan provisions required by the state or federal government without first having to obtain the approval of the
labor groups or retirees. I explained this to the City Council in closed session and explained that
the City would not have the right to make any other changes to the Modified Medical Plan
without first complying with the meet and confer requirements of State law and reaching a
mutually acceptable agreement with the bargaining units. Based on my conversation with the
City Attorney, I also explained to the City Council in closed session that the City could not make
any other changes in the medical plan as it affected retirees, except to add benefits, without the
approval of the retirees. Accordingly, I explained to the City Council in closed session in 1992
that everyone who had retired prior to the effective date of the Modified Medical Plan would be
entitled to the specific medical benefits that were included in the Memorandum of Understanding
for their labor group at the time of their retirement. At the same meeting, I explained the specific
language of Section 6.17, its presence in the Modified Medical Plan document, and the meaning
and limitations of the language.

11. George Bist, the City’s chief labor negotiator in 1992, reported to me in 1992 that
he had been questioned by a labor group during negotiations to renew a Memorandum of
Understanding regarding the meaning of Section 6.17 in the proposed Modified Medical Plan.
Following this meeting with me, George Bist communicated to them this same
meaning/understanding of that language, as set forth above.

12. Following approval by the labor groups of the Memorandum of Understanding
that implemented the Modified Medical Plan, the City did not make any changes in the plan
without consulting with the labor groups. On several occasions while I served as City Manager,
we added medical benefits to the plan and changed third party administrators without obtaining
the approval of the retirees, because I understood that we were not decreasing the specific
medical benefits being received by those who retired after the adoption of the Modified Medical
Plan.

13. During labor negotiations in 1992 through 1998 to establish wages for the
employees represented by the labor groups, the City provided wage increases that were lower
than the increase in the Consumer Price Index and lowered the starting salary of future new
employees in the public safety bargaining units in order to reflect the fact that the City would be
incurring a cost to pay the medical premiums for current employees and retirees. I know this because I participated in the design of the wage benefit packages included in all MOUs negotiated during this period and I approved the wage benefit packages to be presented to the City Council for their review. The labor group representatives understood and accepted that the City was guaranteeing payment of the premiums and maintenance of the specific medical benefits at a cost to the City and that this cost and the benefit to the employees and retirees was part of the compensation package received by employees for their current benefit and benefit upon retirement. I know this because I recall discussing this with various members of the labor group executive boards at the time the MOUs were approved by the labor groups. The lower wages also meant that the employee upon retirement would be receiving a lower retirement payment from the California Public Employee Retirement System, since the retirement payment was based on the employee’s highest year of wages, normally the wage received by the employee at the time of retirement. This savings by the City in retirement payments was intended to assist in offsetting the cost of the City providing medical benefits to retirees following their retirement.

14. In 1980, the City began providing medical benefits to members of the Stockton Police Officers Association who retired from City service. The benefit included payment of the entire premium for a retired employee and his or her dependent until the retiree reached age 62, but not to exceed seven years. The City extended a retiree health benefit to various unions throughout the 1980s and increased the maximum age through which retiree health benefits would be available to age 65. By 1991, the City had extended the Retiree Health Benefit to all City employees through numerous MOUs and City Council resolutions approving those MOUs and benefits, and had added a Medicare supplement benefit for many unions.

15. The MOUs typically described the City as paying “a premium” or “all premiums” for health insurance benefits for retirees until age 65. These terms have always been understood by the City to require the City to pay the entire premium for health insurance for all qualifying retirees and their spouses or one dependent. Attached are true and correct copies of sample MOUs (Exhibit A: Comprehensive Summary of City of Stockton Unrepresented
Management/Confidential Employees’ Compensation Plan (January 1, 1997 – December 31, 2008) at p. 9 [“The City will contribute all premiums necessary”]; Exhibit B: MOU between City of Stockton and Stockton Police Officers’ Association (January 1, 1999 – December 31, 2003 at p. 37 [“the City shall pay a premium”]; Exhibit C: Mid-Management/Supervisory Level MOU (April 16, 2000 – December 31, 2008) at p. 33-34 [“The City will contribute all premiums necessary”]; Exhibit D: MOU with City of Stockton Fire Unit (July 1, 2003 – June 30, 2011) at pp. 38-39 [“The city shall pay a premium”]). Indeed, to the best of my knowledge, until 2011, the City consistently paid the entire premium for health insurance for each of its qualifying retirees and one dependent or spouse. Retiree health benefits were also continued by the City for the surviving spouse of a retiree.

16. The Retiree Medical Benefit was extended as a supplement to Medicare after age 65. The City provides the following timeline in the City’s adopted GASB 45 Report for June 30, 2011:

January 1, 1985 Management & Confidential, Mid-Management and Supervisory, and Law Department
January 1, 1990 Police Management
January 1, 1996 Fire
January 1, 1997 SCEA, Trades and Maintenance, and Fire Management (based on MOU between City and Fire Management)
August 1, 1998 Police

17. Employees hired after March 31, 1986 were enrolled in Medicare but those hired before that date were not. For some of the retirees who had not qualified for Medicare upon retirement, the City began also paying the Part A Medicare premium (or in the alternative at the City’s choice, continuing City medical benefits as primary coverage). This benefit was extended to Police and Fire union members. The City provides the following timeline in the City’s adopted GASB 45 Report for June 30, 2011 for the benefit available to employees retiring after the dates shown below:

January 1, 1996 Fire
January 1, 1997    Fire Management

July 1, 2006    Police and Police Management

Because some of the retirees did not qualify for Medicare themselves or through a spouse, part of the rationale for extending the Retiree Medical Benefit beyond age 65 was that the City had not participated in Medicare prior to 1986. The city had saved money by not having to enroll employees in Medicare prior to March 31, 1986 and continued to save money thereafter on employees hired prior to that date. The existence of the savings and the fact that some retirees would not be eligible for Medicare was part of the reason for the expansion of health benefits beyond age 65.

18. In January 1993 the City changed its medical benefits in order to align them more closely with industry standards and to reduce costs. Any employee who had retired prior to that date was continued on what was called the “Original Plan,” while all current employees and those who retired from that date forward received the benefits in the “Modified Plan.” The City’s unions agreed to give up 20% of their annual cost of living increases in exchange for securing the “Modified Plan” for City employees and future retirees, with the 20% helping to fund the Modified Plan’s annual cost increases.

19. A few changes were made in the Modified Plan in the following years that improved benefits. However, the City did not reduce benefits in the Modified Plan because City officials believed that the benefits received by retirees at the time of their retirement were vested and so could not be changed unilaterally by the City. This understanding—that retiree benefits vest upon retirement and cannot be changed thereafter—was also the reason the City continued existing retirees on the Original Plan, while adopting the Modified Plan for current employees and future retirees.

20. Whenever the City made changes in benefits, including changes in third party administrators, employee unions had the opportunity to meet and confer in a negotiation process with the City regarding the changes if they so desired. However, the City’s retirees were not represented by unions, and the retirees had already completed their end of the employment
contract. For this reason, the City believed that it could not reduce the benefits it offered to
retirees after retirement.

**Stockton’s Retiree Health Benefit Is a Lifetime Health Benefit**

21. The City repeatedly told its employees that the Retiree Medical Benefit was a
benefit that qualifying employees would enjoy for the rest of their lives. Until at least July 3,
2007, to the best of my knowledge the City provided every retiree with a letter upon retirement
that summarized their retiree benefits. The letter described the Retiree Medical Benefit and said
“[t]his is a lifetime benefit for both you and your spouse,” or “[t]his lifetime benefit is provided
to both you are your spouse.” A true and correct copy of one such letter from the City to a
retiree is attached hereto as Exhibit E.

22. The Stockton City Council also reviewed and/or accepted numerous
Comprehensive Annual Financial Reports ("CAFR") that described the Retiree Medical Benefit
as a lifetime benefit. Every CAFR for the City of Stockton from at least June 30, 2001 through
June 30, 2006 describes Post Retirement or Post Employment Health Care Benefits as follows:
“This is a lifetime benefit provided to the retired employee and his or her eligible spouse.”
Similarly, the June 30, 2007 through June 30, 2010 CAFRs state: “This is a lifetime benefit
provided to the retired employee and his or her eligible dependent.” Similarly, the MOU with
the Trades and Maintenance Unit for the period from 2006-2008 (Operation Engineers, Local 3,
AFL-CIO) states: “This lifetime benefit is provided to the employee and the employee’s
spouse.”

**Unions Made Numerous Wage Concessions in Exchange for Continuing the Benefit**

23. The City’s unions made numerous wage concessions in order to maintain benefits
under the Modified Medical Plan. In December, 1996 the San Joaquin Public Employees
Association ("SJPEA") and in March, 2000 the Stockton City Employees Association ("SCEA"),
the successor to the SJPEA, agreed to terms of compensation to be included in the MOUs for the
period 1997 through 2008 that included a lower wage than the unions would have otherwise
agreed to in exchange for the City continuing to pay all of the premium for medical benefits for
employees and their dependents and continuing unchanged the benefits included in the Modified
Medical Plan incorporated as a part of the MOU. The lower wages were also intended to provide savings for the City that would assist in offsetting the cost of providing lifetime medical benefits to retirees.

24. The savings from lower wages were achieved by the City in the following way:
   
   • Starting in January 1, 1994, annual wages increases through January 1, 1996 were to be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not to exceed 4%.
   
   • Starting in January 1, 1995, annual wage increases through January 1, 2008 were to be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not to be less than 2.5% nor more than 6%.

25. The other employee groups made similar wage concessions in exchange for the City continuing to pay the entire health premiums and maintaining the level of benefits provided in the Modified Medical Plan. The Mid-Management/Supervisory unit agreed to annual wage increases that, beginning January 1, 1996, were to be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not to exceed 4%. Starting January 1, 1997 annual wage increases through 2008 were to be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not to be less than 2.5% nor more than 6%.

26. The Stockton Police Officers Association agreed that new employees starting January 1, 1994 would start at a salary level approximately 5% lower than was previously the case. This “six step” pay plan added the lower step at the beginning of what was a “five step” pay plan. Beginning January 1, 1999 the six step pay plan was changed to a nine step plan with each new employee now beginning approximately an additional 15% lower in pay.

27. In addition to the added steps in the pay plan, the Police MOU provided that from Calendar Year 1996 through Calendar Year 1998 annual wage increases were to be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not to exceed 4%. Beginning in January 1, 1999 annual wage increases through 2009 were to be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not
to be less than 2.5% nor more than 6%. Police wages were also to be adjusted in 2002, 2006 and 2008 if a salary survey warranted additional adjustment.

28. The Fire MOU provided that effective Calendar Year 1996 newly hired firefighters would be paid 15% less as a starting salary than previous newly hired employees. This was accomplished by implementing an eight step salary plan to replace a five step plan. An additional lower salary step was added effective July 1, 2003 to create a nine step salary plan comparable to the one in the Police Department.

29. The Fire employee MOU also provided that salary increases from Calendar Year 1997 through 2000 would be 80% of the change in the Consumer Price Index during the previous year, with the wage increase not to be less than 2.5% nor more than 6%. For the following years there were various salary surveys and other means of salary adjustment.

30. These concessions reached further than an employee’s base wage. Overtime and some other benefits are tied to an employee’s wage level, and would also decrease as a consequence of lower wages negotiated in an effort to preserve employee and retiree benefits.

31. Critically, when unions accepted lower wages in order to secure benefits, the result was that many employee’s received a lower wage in their last year of employment. The last year of employment provides the basis for calculating a retired employee’s annual pension payments. Accordingly, not only did employees accept lower wages in exchange for the Retiree Health Benefit and other benefits, but they also received a lower pension for the rest of their life. The City benefited from this concession: not only did the City save money on the lower wages, but the City also paid less to the California Public Employees’ Retirement System (“CalPERS”) in annual pension payments because the City’s pension payments to CalPERS are based on the wages being paid.

Changes to the Retiree Health Benefit

32. After maintaining the level of benefits offered under the Modified Medical Plan for nearly two decades, effective July 1, 2010, the City implemented an increase in the yearly deductible to be paid by retirees participating in the Modified Medical Plan and an increase in the co-pay for drugs. These changes were relatively minor. The deductible increased from $150
to $200 for an individual and from $450 to $500 for a Family. Co-pay for Prescription Drug
coverage was similarly small.

33. In 2011, the City adopted major changes in the Modified Medical Plan that were
projected to save the City 30% per year on medical costs. There were corresponding changes in
coop, deductible and prescription drug provisions. Neither the changes in 2010 nor the
changes in 2011 were made with any attempt by the City to meet with retirees to obtain
agreement for the changes.

34. When the City made the changes in 2011 to the Modified Medical Plan, the City asserted at a June 2011 Council meeting that the unilateral changes were authorized by the
following language that has been in the Modified Medical Plan since its inception in January
1993:

Section 6.17. Amendment and Termination. In order that the Plan may carry out its
obligation to maintain within the limits of its resources, a program dedicated to
providing good benefits for all Employees, the City reserves the right, at any time to
amend either the amount or condition with respect to any benefits payable, and to
terminate the Plan.

35. The City asserted that Section 6.17 gave it the right to make unilateral changes to
retiree health benefits, including requiring retirees to pay their own premiums and ending the
Retiree Medical Benefit altogether for existing retirees. However, the City had never interpreted
it that way in the 18 years since the language was added to the Modified Medical Plan in 1993.
Rather, Section 6.17 was intended and understood to allow the City to change third-party
administrators and make other administrative changes without having to engage in the meet and
confer process with the unions. This true meaning was conveyed to employee unions who
subsequently agreed to inclusion of the language after reassurance regarding its meaning. I
understood Section 6.17 to have this limited meaning during labor negotiations between the City
and the unions. From 1993 until 2010, the City made no changes to benefits offered under the
Modified Medical Plan without consulting with the employee unions, and never once reduced
benefits offered to retirees under the Modified Medical Plan.

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DECLARATION OF DWANE NEIL MILNES

The City Unilaterally Imposes a Plan to Terminate the Retiree Medical Benefit

36. On June 28, 2012, the City declared bankruptcy. The previous day, the City Council adopted a "Pendency Plan," under which it would unilaterally terminate premium payments under the Retiree Health Benefit as of July 1, 2012, for all retirees who had been employed with the City for less than ten years—the Short Term Retirees—and provide only a limited stipend for health insurance premiums for Long Term Retirees, with all premium payments for health insurance benefits to be terminated completely as of July 1, 2013. By letter of June 27, 2012, the City instructed retirees that they must pay their own premium by July 30, 2012 (with or without help by the City's stipend), "or your medical coverage will be cancelled, retroactive to July 1, 2012." Attached as Exhibit F is a true and correct copy of the letter (see p. 3). The City provided this notice only days before this change was to take effect.

37. The City estimates that the cost of the Retiree Health Benefit to the General Fund during the upcoming fiscal year (July 2012-June 2013) is $9.2 million dollars. By implementing its plan, the City estimated it would pay $2.1 in the General Fund for the Retiree Health Benefit, thus saving $7.1 million dollars. It is estimated that it would save a minimum of $9 million dollars in the following year, since it proposes to end all contributions to the Retiree Health Benefit effective July 2013. Attached as Exhibit G is a true and correct copy of Exhibit 10 to a resolution related to the pendency plan and retiree medical benefits, which staff presented to the Stockton City Council on June 26, 2012.

I declare under penalty of perjury under the law of the United States of America that the foregoing is true and correct and that this declaration was executed in Stockton, California on July 10, 2012.

Dwane Neil Milnes