Very Long-Term Contracts

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Introduction

While much of the negotiations process centers on the specific language relating to salaries and benefits, the term of the contract is a vital aspect. Agencies may be comfortable using the same duration previously negotiated without thoroughly considering the possibility of implementing a long-term or very long-term contract. For the purposes of this paper, a long-term contract is defined as 3-5 years, while a very long-term contract is defined as over 5-years. This paper will focus on and address the positive and negative aspects of very long-term contracts and how they can be implemented.

History

Long-term and very long-term Memoranda of Understanding (MOUs) are not a new concept in labor relations. In a Time Magazine article from 1958 the subject was discussed. Even at this time concern was expressed about having a 5-year contract in a “period of economic change (“Long-Term Contracts,” 1958).” In reviewing various California public agency MOUs, most have adopted terms between 1-3 years. Very few agencies have moved toward long-term contracts and increasingly rare are very long-term contracts.

The County Sanitation Districts of Los Angeles County (Districts) has contract records dating back to 1973. From 1973 through 1985, the MOU terms ranged from 1-3 years. 1988 is when the Districts first adopted a 4-year contract and then in 1992 a 5-year contract. In 2005, two of the units adopted 9-year contracts. Before the MOUs expired, negotiations were entered into and one of these units agreed to extend the contract for an additional 5-year period which will keep it in effect until June 30, 2019. The contract language referenced herein was taken from the White Collar MOU which is in effect from March 23, 2011 through June 30, 2019. This unit includes classifications that are clerical in nature (e.g. Typist Clerk, Purchasing Assistant, Customer Service Representative, etc.).

Benefits of Long-Term Contracts

Probably the most often touted benefit of a very long-term contract is the associated labor peace. With each side bringing proposals and counter proposals there is always the chance for negotiations to become combative. There is also the possibility each time negotiations are entered into that no agreement is reached and impasse is declared. These types of situations can
create long lasting issues between labor and management. Reducing the number of negotiations processes could reduce the potential for these types of incidents.

When new contracts are negotiated every year, or even alternating years, there is always the possibility for challenges based on ambiguous language. Very long-term contracts can avoid this because of the established history. This should have a direct impact on the number of grievances received and may result in less administrative burden. While seldom used provisions may still be grieved, an agency is not likely to have a significant number of grievances relating to language that has been interpreted and implemented for several years. With a very long-term contract, the agency has the opportunity to establish a considerable track record with regard to language interpretation and implementation.

Agencies with very long-term contracts should also be able to enjoy a reduced cost of labor relations. Bargaining, especially contentious bargaining, can be very expensive and time consuming. These increased costs can be both internal and external. Internally, Human Resources staff may need to put in additional hours during the negotiations process. Some agencies choose to bring in outside legal counsel for this process and the costs can easily skyrocket.

Issues and Potential Solutions

Naturally there are issues that need to be addressed when entering into very long-term agreements. The main issue with very long-term contracts is the limited ability to make changes and the reduced flexibility. During periods of stability this may be reasonable, but during more turbulent economic times it may not be beneficial to the agency. However, there are measures agencies can take to mitigate these potential problems and implement a very long-term contract. The Sanitation Districts considered many potential issues and included language to address these areas.

In the current economic climate, salaries and cost-of-living adjustments are a chief area of concern. To address salaries in its very long-term contracts, the Districts used a formula based on the Consumer Price Index (CPI). Instead of predetermining an annual cost-of living increase (e.g. 2012 = 3%; 2013 = 2.5%, etc.), the Districts used a formula based on the change in the CPI from March to March. The language states that:

A percent increase to salaries will be based upon the increase in the Consumer Price Index (CPI) for All Urban Consumers for the Los Angeles-Riverside-Orange County area, using the 1982-84 = 100 base, for the period March 2011 to March 2012, according to the following chart:
### Increase in CPI vs. Percent Salary Increase

<table>
<thead>
<tr>
<th>Increase in CPI</th>
<th>Percent Salary Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-3%</td>
<td>Equal to CPI</td>
</tr>
<tr>
<td>3-9%</td>
<td>3% plus 66 2/3% of the increase from 3-9% in the CPI</td>
</tr>
<tr>
<td>9-12%</td>
<td>7% plus 50% of the increase from 9-12% in the CPI</td>
</tr>
<tr>
<td>12% and above</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

*Note: A decrease in the CPI will result in no salary increase.*

The CPI is often used as a gauge of inflation. Inflation is driven by a money supply that increases too rapidly. This results in an increase in the price of goods and services (Flynn, 2005). For many agencies an approach like this would not be recommended since it does not account for the actual revenue received by the agency. An increase in inflation does not necessarily correlate to an increase in public funds. Since public agencies do not have an easy path to increase revenue when faced with shortfalls, financial solvency should be greatly considered before using this approach.

It is interesting to note that the Federal Reserve Bank has acknowledged that the “CPI overstates inflation by 1 to 2 percentage points per year” (Flynn, 2005). This may inadvertently result in cost-of-living increases that outpace actual inflation. Therefore, if an agency is looking to tie cost-of-living increases to the CPI, it must consider this information before determining an appropriate formula.

Another key question to consider is: can we reasonably predict inflation for five years, or even one year in advance? Surprisingly, the answer is probably, yes. Data from 1980 to 2002 shows that estimated and actual inflation numbers were generally within 1 percentage point (Flynn, 2005). While the economy has been less stable in the last few years, it may be possible to predict future inflation with reasonable accuracy if appropriate resources are used. In the last three years the economy has been described as being in a recession. Even with the drastic stock market swings, and high percentage of unemployment, the rate of inflation has been kept relatively low. For example the change in CPI from March to March from 2007-2011 was as follows:

- 2007 (+3.8%)
- 2008 (+3.3%)
- 2009 (-1.0%)
- 2010 (+1.9%)
- 2011 (3%)

Using a cost-of-living formula based on the CPI does not factor in salaries paid by other private and public sector organizations. Since other organizations are likely to use a different approach, especially in the private sector, their salaries may be adjusted more frequently and to a
greater extent. There is the possibility that as other agencies’ salaries increase, the Districts could trail behind. Recruitment and retention could become a new problem with a very long-term contract strategy if salaries do not keep pace with other comparable agencies. To remedy this, the Districts incorporated an inequity reopener. “Reopener clauses can be written to call for future negotiations automatically or at the request of the agency, the union, or by mutual agreement.” (California Public Employers Labor Relations Association [CalPELRA], 2011). In the White Collar MOU, language is included to provide a limited reopener regarding salary inequities in alternating years:

The parties agree to meet and confer in May 2011, May 2013, May 2015, and May 2017, on the subject of possible salary inequities for classes in the Unit. Prior to May 1 [of each specified year], either party may submit written proposals which identify classes for which it proposes a salary adjustment. The District will provide a written decision regarding the inequity requests.

This provision would allow for salary adjustments to keep the Districts competitive with public and private sector employers. While this type of reopener would not provide for a reduction in salaries and/or benefits, it does allow for increases to maintain competitiveness.

Another potential issue is the rising cost of health care and health care premiums. Increases and/or decreases in healthcare premiums may have been easier to predict in the past, but future estimates may be complicated by healthcare reform passed in 2010. The full impact of this new legislation has yet to be determined. According to an article published by the U.S. Department of Health and Human Services, health care premiums increased drastically from 1999 to 2009 (“Health Insurance Premiums,” 2011). The changes implemented as a result of the Affordable Care Act (health care reform) are expected to mitigate the annual premium increases. More specifically, premiums will likely continue to increase but at a slower rate. Support for this premise was shown “in 2010 [when] family premiums in the employer-based market increased by only 3 percent compared to 11.2 percent in 2004 (“Health Insurance Premiums,” 2011). Although health care premiums may be stabilizing, it is important for agencies to consider future increases when negotiating a very long-term contract. This is especially true if the agency agrees to pay for the entire healthcare premium without indicating a specified amount or cap.

To account for the change in medical premiums, the Districts instituted a cost sharing provision for the medical plan premium. Increases above $75 per month are shared equally by the employees and the Districts, except that “the employees’ cost sharing contribution shall not increase in any given year by more than $20 per month.” “The maximum cumulative employees’ cost sharing contribution shall not exceed $100 per month for the term of the agreement.”
Retirement contributions may be one of the most significant considerations since it is a large percentage of payroll, and in turn, a large percentage of agency expenses. Agencies that pay all or a portion of the employee share of the retirement contribution may be hesitant to enter into longer term contracts. For example, the CalPERS actuarial office typically provides estimates of the employer contribution rate for three fiscal years. This is a helpful projection when negotiating, but since this rate is variable it can have a significant impact on the employer’s budget. If an employer negotiates to pay the employee share on behalf of the employee it may become burdensome to pay that amount as well as the increasing employer contribution. A limited reopener may be appropriate and could be implemented in a number of ways. For example, an agency may include language that would reopen the MOU if the employer contribution rate increased beyond a certain percentage. The Districts do not have language that would impact the term of the MOU or benefits provided based on retirement contribution rates.

Also pertaining to retirement contributions is the potential impact of state and even federal legislation. It should be noted that very long-term contracts are not immune from legislative changes. With the current scrutiny of public agencies there is an increased probability that legislative changes would supersede the contract language. Therefore, if an agency wants to preserve the remainder of the MOU, a separability clause should be included. However, if an agency anticipates the change would be costly or otherwise burdensome, it may be beneficial to have a clause that would negate the entire contract and open negotiations. For example, if the agency pays the employee retirement contribution and legislation is passed that would dramatically increase this amount, an agency may want to negotiate some sort of cost-sharing or offset in another area to control costs. The current White Collar MOU includes the following separability clause:

If any part or provision of this Memorandum of Understanding is in conflict or inconsistent with such applicable laws and regulations or is otherwise held to be invalid or unenforceable by any tribunal or competent jurisdiction, such part or provision shall be suspended and superseded by such applicable laws or regulations and the remainder of this Memorandum of Understanding shall not be affected thereby.

Some agencies with a history of unstable financial circumstances may shy away from very long-term contracts, and rightly so. There may be some fear that an agency would have very limited options if they adopt a very long-term contract and then discover the funds are not available. Although drastic, bankruptcy has been used when the contract terms could not be met. The City of Vallejo filed for Chapter 9 bankruptcy due to a $16 million dollar deficit (Jones, 2008). It was reported that 74% of the City’s budget was allocated to public safety salaries and benefits. This was not an easy process for the city and was also costly since the legal fees alone were reported to be $8 million (Jones, 2011). While bankruptcy may be a potential resolution, it
is certainly not recommended and should not be relied upon. If past economic challenges have had a significant impact on the agency’s revenue and budget, a very long-term contract may not be advisable.

The Role of the Zipper Clause

With very long-term contracts, a zipper clause becomes increasingly important. A zipper clause eliminates the duty to bargain over mandatory aspects of bargaining during the term of the contract (CalPELRA, 2011). The Districts White Collar MOU includes the following language:

Except as specifically provided herein, it is agreed and understood that each party hereto voluntarily and unqualifiedly waives its right, and agrees that the other shall not be required, to negotiate with respect to any matter covered herein or with respect to any other matters during the term of this Memorandum of Understanding.

One of the potential issues with a zipper clause in a very long-term contract is that management may want to negotiate due to changed circumstances, especially during these uncertain economic times. The union, however, may be satisfied with the current language and refuse to bargain. In 2010, the Districts requested to open negotiations with each of the nine units to see if new agreements could be reached before the existing MOUs expired. The most significant proposed change impacted the cost-of-living formula. This is important to note because one of the nine units did not reach agreement. As a result, their existing MOU and cost-of-living formula are still in effect through June 30, 2014. If the zipper clause is worded in such a way, either party may refuse to enter into bargaining during the term of the contract. This could pose a problem for the agency if there are budget issues that need to be immediately addressed. However, a reopener limited to wages and benefits may resolve this area of concern. If a very long-term contract is implemented it may be beneficial for the agency to include a reopener that is tied to wages and possibly benefits (e.g. employee retirement contribution rates).

Public and Union Perceptions of Very Long-Term Contracts

The public perception of very long-term contracts may be mixed. If benefits and salaries appear too favorable to the employees, the public can view very long-term contracts as a way to lock in exorbitant benefits to appease the unions. If the public perceives major concessions a very long-term contract can be viewed in a much more positive light. In the current economic times, the public perceptions of very long-term contracts are not likely to be favorable. Even if the agency has negotiated “take-aways”, a very long-term contract can be viewed negatively. If the public perceives that the economy will continue to decline, the contract could be viewed as limiting additional reductions. Overall, it is important that a long-term or very long-term contract be perceived to be reasonable and justified to the public. Any agency entering into a
long-term or very long-term contract should have documentation that the terms would be in the best interest of the agency and the public.

Since many agencies have not used contracts over 3-years, it is difficult to gauge how union representatives would respond to such proposals. It would be expected that during periods of economic prosperity unions may not want very long-term contracts since they would not be in a strong position to come back to the table and ask for more for many years. In more uncertain times there may also be reluctance to enter into very long-term agreements because if things turned around there would also be limited ability to return to the table. Therefore, negotiating long-term and very long-term agreements may be difficult for everyone involved. In the Districts case, the stability and sense of security seemed to be something that management, employees, and the union representatives appreciated.

Conclusion

With the right language, very long-term contracts can be used and may be beneficial for some public agencies. An agency should not enter into a very long-term contract without carefully crafted language, including any necessary reopener, severability, and zipper clauses. The agency should also conduct a thorough analysis of their financial state of affairs and gather information related to external factors like inflation, health care costs, etc. before deciding if a very long-term contract is appropriate.

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References


