MEMORANDUM OF LAW

DATE: June 18, 1992

TO: Larry Gardner, Labor Relations Manager

FROM: City Attorney

SUBJECT: Insurance Rebates

You have requested a response to Joel Klevens' letter dated June 2, 1992, concerning the legality of the City's retaining premium rebates from Cigna Life Insurance Company plans offered to employees through the City's flexible benefits plan.

BACKGROUND

Mr. Klevens, attorney for Fire Fighters Local 145, contends that the City, as policyholder, does not contribute to the payment of the life insurance premiums. Rather, the premiums are paid by the employees. Mr. Klevens maintains the premiums are not expenditures of the City within the meaning of California Insurance Code section 10214, and thus may not be retained by the City in reliance upon Luksich v. Kaiser Steel Corp., 245 Cal. App. 2d 373 (1966). Therefore, according to Mr. Klevens, the premium amounts rebated by Cigna Life Insurance Company should be returned to the employee fire fighters, and we would assume, other City employees, on a pro rata basis.

ANALYSIS

Contrary to Mr. Klevens' assertion, the City does contribute to the payment of life insurance premiums offered through the City's flexible benefit cafeteria plan. Internal Revenue Service ("IRS") regulation 1.125-1 Q&A 6 clearly states: The term

> "employer contributions" means amounts that have not been actually or constructively received (after taking section 125 into account) by the participant and have been specified in the plan document as available to a participant for the purpose of selecting or "purchasing" benefits under the plan. A plan document may provide that the

> employer will make employer contributions, in whole or in part, pursuant to salary reduction agreements under which participants elect to reduce their compensation or to forego increases in compensation and to have such amounts contributed, as employer contributions, by the employer on their behalf. A salary reduction agreement will have the effect of causing the amounts contributed thereunder to be treated as employer contributions under a cafeteria plan only to the extent the agreement relates to compensation that has not been actually or constructively received by the participant as of the date of the agreement (after taking section 125 into account) and, subsequently, does not become currently available to the participant.

This is precisely the method employed for employer contributions under the City's cafeteria plan. The amounts designated by the City for health and life insurance are not currently available to the employee under the definition of "currently available" found in the IRS regulations. Employees do not, and may not, receive the funds designated for health and life insurance and the funds are not taxable to the employee.

Thus, these designated funds are not employees' monies, but rather are funds contributed by the City to purchase employee benefits, including life insurance premiums. The alternative to the City's current cafeteria plan would be to have a single, employer selected health and life insurance plan for all employees. It is clearly in the best interest of the employees to allow each employee to select health and life insurance plans which best fit his or her needs.

California Insurance Code section 10214 provides that any excess of the aggregate premium refunds over the aggregate expenditures for a group life insurance policy made from funds by the policyholder are to be applied by the policyholder for the benefit of the insured employees. Under Luksich, section 10214 does not afford employees any rights to a premium rebate paid to the employer-policyholder where its contributions exceed the rebate. Luksich, 245 Cal. App. 2d at 375.

As noted in my memorandum of law dated April 29, 1992, the City last year paid $555,878.000 in life insurance premiums for its employees and received a rebate of $231,172.00 from Cigna Life Insurance Company. The premiums paid by the City exceed the rebate and Luksich dictates that City employees have no rights to the rebate. As pointed out above, Mr. Klevens' argument that Luksich is distinguishable because the policyholder in that case made contributions to the payment of premiums, while the City has not, is without merit in light of the IRS definition of employer contributions.

Moreover, had the City not made any contributions to the payment of premiums, the fire fighters would still have no right to a pro rata share of the rebate. Section 10214 provides that the excess of rebates over policyholder contributions, if any, are to be applied for the benefit of insured employees generally. See California Insurance Code Section 10214. The plain meaning of the word "generally" requires that the City use the excess rebate for purposes that benefit all, or nearly all, of its insured employees, not individual employees or a discrete group of employees. Providing the City fire fighters a pro rata share of the rebate would not achieve a general application as prescribed under section 10214.

CONCLUSION

Based upon the California Insurance Code, the IRC, and relevant case law, the City has properly exercised its rights by retaining rebated insurance funds and applying the rebates for the benefit of City employees generally.

Should you need further assistance in this matter, please do not hesitate to call.

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By
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