PHILLIP C. ENGERS, WARREN J. MCFALL DONALD G. NOERR, and GERALD SMIT, individually and on behalf of all others similarly situated, Plaintiffs,	:	**UNITED STATES DISTRICT COURT DISTRICT OF NEW JERSEY**
vs.	:	C.A. No. 98-CV-3660 (JLL)
AT&T and AT&T MANAGEMENT PENSION PLAN, Defendants.	:	ORAL ARGUMENT REQUESTED

PLAINTIFFS' MEMORANDUM OF LAW

IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

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Table of Contents

TABLE OF AUTHORITIES

FEDERAL CASES

FEDERAL STATUTES AND REGULATIONS

MISCELLANEOUS

Introduction

Faced with competition from telecommunications rivals such as Qwest Communications and WorldCom, AT&T converted the AT&T Management Pension Plan ("AT&T-MPP") to a "cash balance" pension design effective January 1, 1998. The changes reduced the company's future pension liabilities by approximately $1.9 billion, but at the expense of tens of thousands of employees many of whom lost 20-35% of their expected retirement benefits. Because AT&T has made no contributions to its Pension Plan since 1995, it appears that accounting and share price considerations drove the changes, rather than actual costs. ¶7.[1]

A. The legal issues with cash balance conversions

Cash balance pension plans are hybrids that combine some attributes of defined benefit plans with some attributes of defined contribution plans. They do not fully conform with either plan type. They "mimic" defined contribution plans by referring to individual accounts and annual allocations. But the accounts and annual allocations are only "notational." Typically, the employer establishes hypothetical accounts for each employee and allocates hypothetical pay credits equal to a percentage of an employee's salary. Hypothetical interest credits are then added to the account at a variable or specified rate, e.g., 5.5%. *Esden v. Bank of Boston*, 229 F.3d 154, 158 (2d Cir. 2000). At retirement, benefits can be reconverted to an annuity form, but most participants take payment in the form of the cash balance (AT&T assumes 70% of its employees do this, ¶241).

Under ERISA and the Internal Revenue Code, cash balance pension plans are considered defined benefit plans. *Esden*, supra, 229 F.3d at 158, 162. The statutory provisions applicable to defined benefit plans "limit the extent to which a cash balance plan can mimic the benefit and

[1] References are to the paragraphs in the Statement of Undisputed Material Facts.

accrual structure of a defined contribution plan." IRS Notice 96-8, 1996-1 C.B. 359 (included as Ex. 86). If a plan sponsor selects attributes from both types of plans without conforming with the rules applicable to defined benefit plans, cash balance plans run the risk that the courts will "for 'hybrid' read 'unlawful.'" *Berger v. Xerox*, 338 F.3d 755, 763 (7th Cir. 2003).

Without adequate disclosures, cash balance conversions "mask a lot of changes." AT&T's actuarial expert writes: "For the same reason that it's hard to compare apples with oranges, employees will find it difficult to compare benefits under a cash balance plan with those under the prior traditional plan ...." ¶170.

B. The features of AT&T's cash balance conversion

As described more fully in the Statement of Undisputed Material Facts, AT&T's Board of Directors met in April 1997 to authorize the Senior Vice-President for Compensation & Benefits to adopt "Special Update" amendments effective January 1, 1997 which improved the retirement plan's 1.6% of pay formula by moving the "pay window" from an average based on pay in 1987-92 to an average based on pay in 1994-96. Those amendments included a temporary five-month freeze of accruals under all benefit formulas between August 1, 1997 and December 31, 1997. Concurrently, the Board authorized Cash Balance amendments that would become effective on January 1, 1998 and have the effect of permanently reducing the future rate of benefit accruals to 1.35 - 1.4% of pay–a reduction of approximately 15% from the prior formula, with still greater reductions after age 55. The Cash Balance amendments also changed the Plan's provisions for early retirement from an undiscounted benefit at age 55 to a less favorable set of reduction factors. As finally approved by a delegate of the Senior Vice-President on October 16, 2000, the cash balance amendments attached a contingency to the payment of any of the future cash balance accruals. This contingency (called

a "wear-away") had the effect of freezing additional accruals for older and longer-service employees for up to 13 years. To "sell cash balance," AT&T decided not to disclose the "bad parts" of the cash balance conversion to the employees.

I. Neither the Board nor its delegate amended the AT&T-MPP to adopt the adverse rules on benefit accruals and benefit options until October 2000

Plaintiffs' Fourth and Fifth Claims allege that AT&T did not amend the Plan document in a timely manner to adopt two of the most adverse rules on benefit accruals and benefit options. This Court recognizes that the "information concerning the date of Plan amendments may be germane to Plaintiffs' ... claim that AT&T had not adopted actual Plan amendments containing the cash balance feature and transition provisions prior to a certain date." Dec. 4, 2003 Slip Op. at 5.

A. Two of AT&T's substantive changes were untimely

The facts developed in this litigation show substantive differences between the AT&T Board's April 1997 resolutions and two amendments approved on October 16, 2000. Those facts are set forth in full in ¶¶11-63 of Plaintiffs' Statement of Undisputed Material Facts and offered here in outline form. On or after April 16, 1997, AT&T's Board of Directors adopted a number of resolutions, some of which were to change the benefit formula in the AT&T-MPP from a traditional defined benefit formula to a "cash balance" formula, with an effective date of January 1, 1998. ¶¶12-14. The resolutions delegated to the Senior Vice-President of Compensation & Benefits the responsibility of (a) drafting appropriate language to reflect the intent of the resolutions; (b) making "such other administrative amendments necessary or appropriate to implement the resolutions and that are consistent with the intent of the cash balance design presented to the Board"; and (c) making "such other changes as are necessary to comply with any applicable law." ¶¶12-15.

Although the cash balance formula was effective as of January 1, 1998, amendments

incorporating it into the Plan were not adopted by Brian Byrnes (to whom the Senior Vice-President had delegated his authority) until October 16, 2000 (the "Cash Balance Amendments"). ¶23. Indeed, the Cash Balance Amendments were not adopted until after responses to discovery requests were due in this litigation. ¶¶30-32. When employees asked for the Plan document and amendments, which ERISA requires the Plan administrator to have available and produce on request, AT&T told them that the Plan documents were "being revised" and were not available. ¶¶26-27.

When the amended Plan document was finally produced in response to the document requests in October 2000, it contained two provisions that (1) were not adopted by the Board or contained in any earlier Plan amendment, (2) cannot reasonably be characterized as reflecting the manifest intention of the Board in April 1997, and (3) were never made available for inspection by plan participants prior to that date. Those two provisions are the "wear-away" rule and provisions that base the residual annuity under a cash payment option and a joint & 100% survivor option on the cash balance account even if it this not the participant's highest benefit.

1. The "wear-away" rule under which the cash balance pay and interest credits are not actually paid

Section 4.06(a)(ii) of the October 2000 Plan document provides that the cash balance formula will not actually provide additional benefit accruals until the cash balance account expressed as an annuity exceeds the annuity previously earned under the "pay-base" formulas (the "prior" formulas) in effect before cash balance. ¶38. Because AT&T's consultants deliberately set back the starting point under the cash balance account, a period of years was created where a participant's previously-earned benefits under the "prior" formula would actually exceed the annuity benefits under the cash balance formula. During this period, the participant accrues no additional benefits. In effect, the participant works for AT&T with no pension benefits. Such a period is referred to as a "wear-away,"

because it effectively draws down the value of previously-earned benefits, as if they were "advances" on future pay and benefits that must first be paid back to AT&T. ¶¶39-40 and 181-82. AT&T calls this a "greater of" or "crossover" rule, but "wear-away" is the more common and descriptive term.

Before October 16, 2000, AT&T's Plan document provided that annual accruals were always cumulative. Each year's benefit accruals were "plus" the benefits earned in earlier years. ¶¶40 and 130. AT&T concedes that the April 1997 Board resolutions do not mention a wear-away or a crossover rule. Indeed, it is undisputed that the members of the Board's Compensation and Employee Benefits Committee (CEBC) were unfamiliar with those terms. ¶¶41-45. Slides prepared for non-Board presentations indicated that "younger employees" would begin earning additional benefits "immediately" while it would take other employees "3-8 years." See Ex. 43 at 12509. But those slides were never shown to the Board. ¶42. In response to a document request, AT&T admitted there are no documents relating to the Board's intention about crossover. ¶49. AT&T's Rule 30(b)(6) witness testified, "They [the Board] didn't say you could. They didn't say you could not." ¶43.

In short, AT&T's Board of Directors did not adopt crossover in April 1997. Moreover, the Board did not possess "all the material facts" related to wear-away from which a reasonable argument in favor of an implied amendment could be made. While a wear-away provision may not be "inconsistent" with a transition from a traditional to a cash balance formula, it is undisputed that it is not a legally-required or necessary feature of such transition. One survey finds that well in excess of 50% of cash balance conversions avoid wear-away. ¶¶47-48 and 182-184.

Finally, in the 3½ years before Section 4.06(a) was adopted, the Plan administrator did not actually apply the "greater of" rule that the Board's delegate ultimately approved, but instead paid benefits under a software program that expressly calculates payments "irrespective of [the] greatest

benefit." ¶52. Although Section 4.06(a) purports to be effective January 1, 1998, the Plan administrator has never literally paid participants the "greater of" two benefits, but only pays participants one of two benefits "irrespective of [the] greatest." ¶53. In other words, even today, the plan's actual practice remains inconsistent with the Plan document.

2. The rules that base the residual annuity and joint & 100% survivor option on the cash balance annuity even if it is not the highest benefit

Section 4.06(b) of the 2000 Plan provides that under the cash payment option any residual annuity is based on the cash balance annuity–even if the participant's Special Update annuity offers a higher benefit.[2] Under the same section, a joint & 100% survivor's annuity is also computed based on the cash balance annuity–even if the participant's annuity under the Special Update is higher. ¶55. Not only was there nothing in the 1997 Board resolutions about this, but the Senior Vice President who made the presentation to the Board testified he believed that any annuity option had to be based on the highest of the participant's annuity amounts. ¶57. A draft Plan document dated 9/2/1999 contains rules consistent with the Senior Vice-President's understanding. ¶63. The changes only surfaced in the October 16, 2000 amendments.

B. The Third Circuit does not recognize informal plan amendments

In *Curtiss-Wright v. Schoonejongen*, 514 U.S. 73, 85 (1995), which originated in the District of New Jersey, the Supreme Court held that if a plan document has general or detailed amendment procedures, the courts must enforce those procedures as statutory obligations: "whatever level of specificity a company ultimately chooses, in an amendment procedure ... , it is bound to that level."

The Plan administrator is required to make the plan document, which "necessarily includes

[2] The cash payment option is limited to one times salary plus $30,000 so many participants are due a "residual annuity" under it.

any new, bona fide amendments," available for inspection by participants. *Schoonejongen*, supra, 514 U.S. at 83 (citing ERISA §104(b)(2), 29 U.S.C. §1024(b)(2)). This enables employees "to determine with certainty at any given time exactly what the plan provides." *Curtiss-Wright v. Schoonejongen*, 143 F.3d 120, 124 (3d Cir. 1998) (on remand); see also *Smith v. National Credit Union*, 36 F.3d 1077, 1081 (11th Cir. 1994) ("in the absence of documents, it would be impossible for participants to compare any "notices" that they might receive with the amendments themselves").

In a line of precedents which have been followed in other circuits, the Third Circuit has resoundingly rejected implied Plan amendments and the retroactive application of adverse amendments that are formally adopted after-the-fact. In *Confer v. Custom Eng'g Co.*, 952 F.2d 41, 43 (3d Cir. 1991), a bulletin board notice and speech by the company's president announced an amendment eliminating health coverage for motorcycle accidents and the president later adopted the amendment in the duly-authorized form. But the Third Circuit held that "neither the speech nor the bulletin board announcement could effectively change" the written plan: "Only a formal written amendment, executed in accordance with the Plan's own procedure for amendment, could change the Plan" and then "the amendment could operate only prospectively."[3]

If no substantive difference separates a specific action taken by trustees at a meeting with a later formal plan amendment, the distinction between the two may not be drawn. *Huber v. Casablanca Indus.,* 916 F.2d 85, 105-6 (3d Cir. 1990) (amendment evidenced by written and signed minutes of trustees meeting was effective despite absence of formal amendment to the Plan

[3] See also *Schoonejongen*, supra; *Hozier v. Midwest Fasteners*, 908 F.2d 1155, 1163 (3d Cir. 1990) ("amendment" ineffective when it was not put in writing before employees were terminated); *Smathers v. Multi-Tool, Inc.*, 298 F.3d 191, 195 (3d Cir. 2002) (distinguishing an amendment that changes a "procedural" rule and explaining that *Confer* holds that ERISA does not allow plan sponsors to retroactively adopt "substantive" amendments that "change the coverage under the plan or substance of [the employee's] benefits or his entitlement to them").

document). But the Third Circuit's precedents and the *Restatement of Trusts* firmly reject implied amendments. See *Schoonejongen*, supra, 514 U.S. at 85 (the company is bound to "whatever level of specificity" it "chooses in an amendment procedure"), and *Restatement of Trusts*, §331 comment d (When a procedure for making changes is specified in a trust instrument, changes can be made "only in that manner"). Even when implied changes are recognized in other contexts, the authorized decision-makers must possess "all the material facts." *Koprowski v. Wistar Inst. of Anatomy*, 1993 U.S. Dist. LEXIS 4867 *14 (E.D. Pa. April 6, 1993).

When the Board delegates authority to adopt amendments to carry out the intentions of a resolution, the changes specified in later amendments are "adopted" at the time they are approved, not "as of" the date of the earlier resolution. In *Scott v. Admin. Comm. of Allstate Agents Pension Plan*, 113 F.3d 1193, 1197-99 (11th Cir. 1997), a Board resolution did not contain some of the changes that Allstate adopted in conformity with the plan's procedures two years later. Although company officials "clearly believed the resolution had accomplished, without more, an amendment to the plan," the Eleventh Circuit ruled that the resolution "could not fairly or reasonably be regarded by its terms as constituting an amendment." In *Warren v. Cochrane*, 235 F.S.2d 1 (D. Maine 2002), a Board resolution offered a benefit increase to "retired employees (as of December 31, 1990)." An amendment drafted later limited the increase to "each Retired Gannett Participant who is in pay status as of December 31, 1990." 235 F.S.2d at 5. Although the Benefits Manager and CFO considered the amendment "consistent with management's proposal" to the Board, the district court found "nothing in the resolution that "sets forth" the language "ultimately incorporated." "[W]hatever was said or explained" at the Board meeting, "those present did not come away with a monolithic understanding that retirees not in pay status ...were to be excluded." 235 F.S.2d at 6-7.

C. Analysis and remedies

The format of the AT&T Board's April 1997 resolutions is identical to January and March 1998 resolutions considered in *Henkin v. AT&T*, 80 F.S.2d 1357 (N.D. Ga. 1999), which also involved the AT&T-MPP: Both use the format of "resolving" as of a certain date that the AT&TMPP "be amended to provide" that employees shall be eligible for benefits described in the resolutions. Compare ¶14 with 80 F.S.2d at 1358. To the extent the cash balance resolutions "set forth some of the eligibility and benefits information" they may constitute plan amendments with no further action, but to the extent they leave "matters to be resolved after further discussion" the amendments are adopted only as of the date that those changes are approved by a duly-authorized delegate. See *Henkin*, 80 F.S.2d at 1360 (it was "meritless" for plaintiffs to argue that January 1998 resolutions constituted the amendments "by themselves").

There is no genuine dispute that AT&T's Board adopted cash balance resolutions in April 16, 1997 that were not "self-executing," ¶41, or sufficient "by themselves." *Henkin*, supra, 80 F.S.2d at 1360. There is also no genuine dispute that two of the most adverse provisions that AT&T has applied to plan participants were not in the Board's resolutions and were not presented to the Board: The Board's resolutions did not contain (1) the "wear-away" provision in Section 4.06(a) of AT&T's Plan document, which effectively treats previously-earned benefits as an advance against future benefits, or (2) the rules in Section 4.06(b) under which the annuity under the cash payment and joint & 100% survivors' options are based on the cash balance annuity even if the Special Update annuity is higher. These rules were not adopted by a delegate of the Board until October 16, 2000.

By implementing two "cash balance" provisions without a written Plan Document, AT&T violated ERISA §402, 29 U.S.C. §1102, which requires that "[e]very employee benefit plan shall be

established and maintained pursuant to a written instrument." AT&T also violated ERISA §404, 29 U.S.C. §1104, which requires, that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and ... (D) in accordance with the documents and instruments governing the plan ...." AT&T further violated ERISA §§104(b)(2) and (b)(4), 29 U.S.C. §§1024(b)(2) and (b)(4), which mandate that Plan documents, including "any new, bona fide amendments," must be made available for inspection by participants upon request. AT&T never made the Plan amendments adopted in October 16, 2000 available for inspection before that date.

Confer and the related Third Circuit decisions establish that adverse rules can "operate only prospectively." *Confer*, supra, 952 F.2d at 43; see also *Schoonejongen*, 143 F.3d at 123-24 (a ratification cannot "relate back so as to defeat intervening rights" of participants). The remedy for these violations is to invalidate the application of the provisions until they are properly adopted and made available to participants for inspection. Because the wear-away/"greater of" rule was not adopted until October 16, 2000, the employee class must receive their benefits under the cumulative "plus" provision that was in effect until that date. In mathematical form, they must receive A "plus" B, where A represents their previously-earned benefits before 1998 and B is the additional pay and interest credits they were to earn under cash balance in each year thereafter.

The same remedies are appropriate for AT&T's failure to timely adopt and make available for inspection the rules that restrict the annuity used under the cash payment option and the joint & 100% survivor's option. Participants who chose cash payment options before October 16, 2000 must have their benefits computed without any retroactively-adopted restriction, i.e., their benefit options should be based on the Special Update annuity if this was their higher benefit.

II. AT&T had a duty as Plan administrator to notify participants that the rate of benefit accrual under cash balance was lower

Before 1986, plan sponsors sometimes adopted amendments reducing future retirement benefit accruals without giving notice to participants until a summary of material modification (SMM) was required to be distributed. Department of Labor regulations allowed distribution of a summary of material modification to be postponed until 210 days after the close of the plan year in which the amendment was adopted. 29 C.F.R. 2520.104b-3. After ERISA §204(h), 29 U.S.C. §1054(h), was enacted in 1986, a plan amendment that significantly reduces future benefit accruals cannot take effect without an understandable notice of the reduction to the employees not less than 15 days before the amendment's effective date. ERISA §204(h) provides:

> that a plan ...may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice, setting forth the plan amendment and its effective date to ... each participant in the plan.

Id.; *Davidson v. Canteen Corporation*. 957 F.2d 1404,1406-7 (7th Cir.1992).[4]

A. Advance notice of the parts of the cash balance changes that reduce benefits was not provided by the April 1997 announcement or the November 1997 brochure

Paragraphs 64-134 of Plaintiffs' Statement of Undisputed Material Facts provide a description of the related facts. Reductions in future accrual rates have occurred in many cash balance conversions and while everyone agrees in principle that companies should be honest about reductions, notice of the reductions has been lacking in practice. ¶¶64-66. The Plaintiffs' actuarial expert, Claude Poulin, demonstrates in his Report that AT&T's cash balance formula reduced the

[4] Section 204(h) was amended in several respects in June 2001 by EGTRRA, P.L. 107-16, and new regulations were issued on April 9, 2003, which are codified at 26 C.F.R. 54.4980F-1.

rate of future benefit accruals from 1.6% to between 1.35% and 1.04% of pay, i.e., a reduction ranging from 15% to 35%, depending on age. ¶¶68-72. These conclusions are confirmed by AT&T's own spreadsheets, graphs, bar charts, internal memos and testimony. ¶¶73-78, 109, 126, and 128. For instance, the Plan's chief actuary testified that the "rate of benefit accrual" under the cash balance formula is "lower." ¶77. AT&T and its actuarial expert also concede that the Cash Balance amendments introduced a frozen "minimum benefit" provision, which meant that new accruals were no longer always in addition to, i.e., "plus," the participant's old benefits. ¶¶79-81 and 141-46.

AT&T maintains that it gave the participants the Section 204(h) notice in an April 1997 letter and fact sheet. But this communication only told participants in a "Key Dates" chronology that accruals under the benefit formula in effect before the Special Update "ceased" as of July 31, 1997. The next item told participants that the Special Update improvements become effective on August 1, 1997–the next day. The communication did not say anything about a temporary five-month freeze on accruals followed by permanent reductions in rates under cash balance starting January 1, 1998. Employees were instead told that details about cash balance were not yet available. ¶¶93-94 and 98.

In his report, the Plaintiffs' communications expert, Professor James Stratman, finds that AT&T offered no understandable notice in either the April communication or in a later November brochure about the 15-20% reduction in accrual rates under cash balance or the wear-away rule that could freeze the payment of even those accruals for up to 13 years. ¶¶101-102. Surveys that AT&T commissioned confirm Professor Stratman's findings. In June and September 1997, fourteen focus groups of AT&T managers complained about the "sell" or "spin" in AT&T's communications about cash balance and asked AT&T to provide honest "comparisons of old vs. new" and "come right out and say it" if the company needs to "reduce benefits." ¶¶104-5 and 202. Telephone callers, individual

employees and even HR Leaders asked the same questions. ¶¶203-4. But AT&T deliberately suppressed responsive information. ¶¶106-112, 119-20, 123, and 205-210. AT&T's communications expert agreed that it would not have been technically difficult to disclose the benefit reductions if AT&T had wanted to. ¶131.

B. The applicable law and remedies

ERISA §204(h) requires advance notice of reductions in the rate of future benefit accruals. As the statutory language directs, the "rate of future benefit accrual" under an amendment is compared with the prior rate. Temporary regulations issued in 1995 and made final in 1998 provide that the "amount of the future annual benefit commencing at normal retirement age" is compared. 26 C.F.R. 1.411(d)-6, Q&A 5 and 7. An example is given where a plan's projected normal retirement benefit of 50% of average pay is not changed but the rate at which those benefits accrue in the future is modified. 1.411(d)-6, Q&A 6 (Example). In a recent regulatory preamble, the Treasury Department confirms that rates of future benefit accrual are determined "annually" for purposes of Section 204(h), i.e., the "benefits accruing for a year" are compared. 68 F.R. 17277, at 17279 (Apr. 9, 2003). The regulations also provide that notice is required not only for direct reductions in dollar or percentage rates, but also indirect reductions, like the introduction of a "minimum benefit" that has the effect of reducing future rates. 1.411(d)-6, Q&A 6.

Complying with Section 204(h) is the responsibility of the "plan administrator." Because ERISA §3(21)(A) provides that fiduciary responsibilities attach to plan administration, this means that deciding whether the ERISA §204(h) notice is required and preparing an understandable notice of any reductions are duties that demand the highest standards of loyalty and honesty to plan participants. See, e.g., *Donovan v. Bierwirth,* 680 F.2d 263, 272 n.8 (2d Cir. 1982) (the fiduciary

standard is the "highest known to the law"), *Glaziers & Glassworkers Local 252 Annuity Fund v. Newbridge Sec.,* 93 F.3d 1171, 1181 (3d Cir. 1996) ("duty to disclose material information is the core of a fiduciary's responsibilities").

The expert report of the class' actuary, Mr. Poulin, follows the Treasury Department's method for determining rates of accrual. Mr. Poulin's report demonstrates how AT&T's cash balance conversion substantially reduced future annual benefits after January 1, 1998. In Excel spreadsheets, graphs, bar charts, charts with percentage comparisons, and other documents, AT&T computed the same reductions as Mr. Poulin. ¶¶73-78. Any effort by AT&T to distinguish the "accrual rates" that it computed from the rate of benefit accrual under ERISA §204(h) does not hold up to scrutiny. AT&T's contemporaneous computations all show lower benefits under cash balance and AT&T concedes that it did not compute accrual rates in any other manner. ¶125. Moreover, Section 204 does not support the proposition that accrual rates can be computed differently from one subsection to another, see, e.g., *Cooper v. IBM Personal Pension Plan*, 274 F.S.2d 1010, 1016 (S.D. Ill. 2003) (rejecting defendant's effort to argue "that the term *benefit accrual* [in §204(b)(1)(H)] means something different than the term *accrued benefit*," finding that the difference in terms is grammatical instead of substantive).

Requests for information about any benefit reductions from HR Leaders, focus groups of managers, and individual employees functioned as requests for information as described in *Bixler v. Central Pa. Teamsters Health & Wel. Fund*, 12 F.3d 1292, 1300-1 (3d Cir. 1993). Even assuming arguendo that AT&T could have believed that the cash balance changes had been adequately summarized, the requests showed that the changes were "confusing" and "likely to be misunderstood." *Harte v. Bethlehem Steel*, 214 F.3d 446, 453 (3d Cir. 2000). AT&T violated its

responsibility as Plan administrator when it failed to give the employees "understandable" notice that (1) benefit accruals were temporarily frozen for the five months between August 1, 1997 and December 31, 1997; (2) future benefit accruals under cash balance were being reduced by 15-20% at ages up to 55, and higher percentages after age 55; and (3) a wear-away contingency was being placed on the payment of any of the future benefit accruals--which meant that the future cash balance pay and interest credits would not payable at all for thousands of older or longer service employees.

With respect to the first point, *Brody v. Enhance Reinsurance Co.*, 2003 U.S. Dist. LEXIS 3785, at * 34-36 (S.D.N.Y. March 14, 2003), shows that Section 204(h) is not satisfied by a notice announcing a temporary one-day cessation of benefits without going on to tell participants that the temporary freeze is followed by further benefit reductions. The argument that the "baseline" accrual rate drops to zero with a one-day freeze so that everything thereafter can be considered an improvement is simply an effort to avoid the statutory notice requirement. *Id.*

With respect to the second point, *Koenig v. Intercontinental Life*, 880 F.S. 372, 375 (E.D. Pa. 1995), shows that a Plan administrator is not authorized to develop alternative post hoc tests for benefit reductions in an effort to excuse non-compliance. In *Koenig*, a company attempted to compare future benefits under its amended formula with benefits under the formula as it existed two amendments earlier because this test showed fewer reductions. The court rejected this even though the company protested that the immediately preceding formula was "in effect for only one year."

With respect to the third point, the contingency on the payment of future accruals in Section 4.06(a) has meant that thousands of participants, including each of the named Plaintiffs, received nothing more in pension benefits for their service after 1997. The Treasury regulations require understandable notice of provisions that have the effect of reducing the future rate of accruals. This

includes "minimum benefit" provisions, as well as any other rule that has the effect of excluding "current participants from future participation" in benefits. 26 C.F.R. 1.411(d)-6, Q&A 6.

AT&T further violated Section 204(h) with respect to the "wear-away" contingency because any notice that AT&T gave in 1997 was, by necessity, before the final drafting and approval of the wear-away provision in the October 2000 Plan document and thus before that amendment was made available for inspection by any participants. A Section 204(h) notice must be given "after adoption of the amendment" and before its effective date. In *Production & Maintenance Employees Local 504 v. Roadmaster Corp.*, 954 F.2d 1397, 1403 and 1406 (7th Cir. 1992), notice "fail[ed]" when it "came before the plan amendment was adopted." The Seventh Circuit rejected the contention that an amendment which was adopted two years after the purported notice was just a "clarification."[5]

When a Section 204(h) notice is not given in the manner the law prescribes, the courts have not hesitated to declare the undisclosed reductions ineffective and the prior provisions as continuing in force. *Production and Maintenance Employees Local 504*, supra, 954 F.2d at 1404 ("Section 204(h)'s language is ... clear and imperative: a plan "may not be amended" absent proper notice." Roadmaster's §204(h) violation "rendered the June 27 amendment ineffective. Because the ... amendment was ineffective, it follows that the plan continued in force as if it had not been amended. Therefore, Roadmaster was obligated to continue accruing benefits as the plan provided until it properly amended the plan"); *Normann v. Amphenol Corp.*, 956 F.Supp. 158, 165-66 (N.D.N.Y. 1997) ("Section 1054(h) explicitly states that an amendment cannot become effective until a "plan

[5] See also *Abels v. Titan Int'l*, 85 F. Supp.2d 924, 936-7 (S.D. Iowa 2000) (rejecting argument that employer complies with "spirit" of the notice rule if it shows "actual or constructive notice" to participants before the effective date, even though amendment was not properly adopted until five years later).

administrator provides a written notice, setting forth the plan amendment""); *Koenig v. International Life Corp.*, 880 F. Supp. 372, 376 (E.D. Pa. 1995) (1989 benefit formula continued in absence of required notice of reduction). Here, appropriate equitable relief requires the prior accrual rules, which offered participants their previously-earned benefits "plus" 1.6% of each year's pay, must continue in effect until an understandable notice of reductions is given.

III. AT&T's benefit accruals do not satisfy ERISA's 133⅓% rule because pay and interest credits whose payment is conditional cannot be used to demonstrate compliance

To prevent plan sponsors from "backloading" benefit accruals to later years of service, ERISA establishes three alternative accrual standards. The "accrual provisions provide a formula for calculating the amount of the normal retirement benefit at any given time." *Hoover v. Cumberland Md. Area Teamsters Pension Fund*, 756 F.2d 977, 983-84 (3d Cir. 1985). Because cash balance formulas base benefits on each year's pay, instead of final or highest average of pay, "it is undisputed that the only test" a cash balance plan "might satisfy is the so-called 133⅓ percent test under ERISA section 204(b)(1)(B) [29 U.S.C. §1054(b)(1)(B)]." *Esden v. Bank of Boston*, 229 F.3d at 167.

A. The design of AT&T's hypothetical pay and interest credits does not conform with ERISA's 133⅓% accrual rule

The relevant facts are set forth in ¶¶135-153 of Plaintiffs' Statement of Undisputed Material Facts. Before and after the cash balance amendments, AT&T represented to the Internal Revenue Service that it "satisfies" ERISA's 133⅓% accrual method. ¶135. However, Section 4.06(a)(ii) of the amended Plan document approved on October 16, 2000 (on "Payment of Pensions") provides that the pension benefit of a participant whose pension commencement date is before the normal retirement age will only be the "greater of" the benefit accrued under the prior pay-based formulas through January 1, 1997, with no additional accruals, or the benefit accrued under the cash balance

formula. ¶137-38. Under the prior plan provision, the benefits a participant accrued in a plan year were always "plus" any benefits the participant had already earned. ¶136. The amended Plan provision makes the benefit accrued under the traditional formula a "frozen minimum benefit." ¶80. The participant earns no additional accruals unless and until the benefit accrued under the cash balance formula becomes greater than the frozen benefit under the traditional formula. ¶¶141-145.

Mr. Poulin's Report illustrates how named Plaintiff Donald Noerr was eligible for a pension benefit of $ 18,276 a year or $ 1,523 a month for his service before 1997. When he retired four years later, his pension had not increased by a single dollar. ¶139-140. The pay and interest credits that Mr. Noerr "accrued" under cash balance between 1998 and 2002 were analogous to a three-card monte game ("now you see it, now you don't"). By contrast, "younger employees" and new hires earn "annual rates" of accrual under cash balance "immediately" and without restriction. They do not have an intermediate period of years with no accruals. ¶146. Mr. Poulin shows that if Mr. Noerr continued working to age 60 his accruals eventually would resume again in those "later plan years" (albeit at the lower cash balance rates). ¶¶144-145. In AT&T's words, the cash balance "accrual pattern" always "move[s] ahead" of the prior plan benefits "beginning at about age 60." ¶143.

B. The applicable law on "annual rates" of accrual and the remedies

ERISA's 133⅓% rule is a cumulative accrual method under which the participant's accrued benefit equals the sum of "annual rates" of accrual within a prescribed range. The 133⅓% test is applied by determining the annual rate of accrual on a "plan year" by "plan year" basis because the "test requires that the value of the benefit accrued in any year may not exceed the value of a benefit accrued in any previous year by more than 33%." *Esden*, 229 F3d at 167, note 18. The 133⅓% test mandates that the "annual rate" of benefit accrual in "any later plan year" cannot exceed the rate

of accrual in any earlier plan year by more than 133⅓%. If the Plan document does not prescribe an annual accrual rate on its face, e.g., 2% of compensation, the annual rate must be computed on the basis of the accrued benefit at the end of the year less the accrued benefit at the beginning of the year divided by compensation. Ex.88 (IRS Technical Advice Memoranda). The IRS recognizes that there must be a "separate benefit that each employee accrues for a plan year." For cash balance plans, the separate benefit must be "an annuity that is the actuarial equivalent of the employee's hypothetical allocation for that plan year, including the automatic adjustments for interest through normal retirement age." 26 C.F.R. 1.401(a)(4)-8(c)(3)(vi).

If the benefits for a plan year have restrictions attached to them so that they effectively "will accrue only as of later dates," the accruals cannot be counted in the earlier plan year. IRS Notice 96-8, 1996-1 C.B. 359. The statutory text confirms this principle in two places by referring to the "annual rate" of accrual "payable at the normal retirement age." ERISA §204(b)(1)(B). *Esden v. Bank of Boston,* supra, 229 F.3d at 167 n.18 and 168, likewise holds that a plan sponsor "tries to have it both ways" if it claims accruals for purposes of complying with ERISA's 133⅓% rule for a plan year, while continuing to restrict the right to actual payment. In *Central Laborers' Pension Fund v. Heinz*, 124 S.Ct. 2230, 2004 U.S. LEXIS 4028, *11 (June 7, 2004), the Supreme Court recently ruled unanimously that "placing materially greater restrictions on the receipt of [a] benefit "reduces" the benefit just as surely as a decrease in the size of the monthly benefit payment."

ERISA Section 204 establishes a two-pronged statutory scheme for benefit accruals earned before and after a plan amendment, such as the 1998 change to the AT&T-MPP. An "anti-cutback" rule in ERISA §204(g) rule protects benefits earned before the amendment, including any valuable early retirement rights. Accruals after the amendment must be earned and payable in conformity with

one of ERISA's accrual rules, which for cash balance plans means ERISA §204(b)(1)(B)'s 133⅓% rule. The 133⅓% rule does not permit the plan sponsor to make the statutory right to an "annual rate" of accruals for "plan years" after the amendment contingent on giving up part of the statutory right to benefits earned before the change. The two rights reflect benefits earned in different time periods and are not available for set offs.

In interpreting protective employment legislation, the general rule is that individual statutory rights cannot be waived. *Brooklyn Sav. Bank v. O'Neil*, 324 U.S. 697, 708 (1945) ("no one can doubt that to allow waiver of statutory wages by agreement would nullify the purposes of the [FLSA]"). ERISA has not been interpreted so strictly, but employees can waive their ERISA rights only if the waiver is voluntary and in exchange for more than the benefits to which the employee is already entitled. *Laniok v. Brainerd Mfg.*, 935 F.2d 1360, 1367-68 (2d Cir. 1991). This means that the employer cannot make one uncontested statutory right contingent on the employee waiving or surrendering part of another right. In *Esden*, supra, 229 F.3d at 173, the Second Circuit held that "The statutes nowhere provide for an exception allowing a plan to offer an employee the voluntary choice of a partial forfeiture in exchange for a particular form of benefit." [6]

In this instance, a secondary delegate of the Board eventually adopted a Plan provision which forces participants into an "either/or" choice between statutory rights. Choice #1 offers the benefits to which the participant is entitled under ERISA §204(g)'s anti-cutback rule for plan years before 1998, but with no accruals for future years of employment. Choice #2 offers benefit accruals for future years after 1998 computed at least nominally under ERISA §204(b)(1)(B), but combined with

[6] See also *Lorenzen v. Sperry & Hutchinson Ret. Plan*, 896 F.2d 228, 236 (7th Cir. 1990) (refusal to pay "incontestably entitled" benefits unless participant drops a claim to additional benefits is "a breach of fiduciary duty, with overtones of duress and conversion").

an up to 50% discount to the benefits the participant earned before 1998.

If plan sponsors were allowed to develop tie-in arrangements like this, it would open the gates to diminishing the statutory protections. To illustrate, if a company can count "annual rates" of accruals for the purpose of demonstrating compliance with the 133⅓ percent test, but attach conditions to actually paying those benefits, the company could condition payment of the required accruals on making the participant give up practically anything, e.g.:

(a) The previously-applicable benefit percentage for past years of credited service, e.g., requiring the participant to accept 1% of pay in place of 1.6% for all past years;

(b) Part of any other benefit, e.g., retiree health benefits, 401(k) benefits, or part of a valuable statutorily-protected right to early retirement benefits (as occurred here).

Plaintiffs respectfully submit that this gate is not open. In *Esden,* 229 F.3d at 167 n.17, the Second Circuit found that "For the purposes of demonstrating compliance with the 133⅓ percent test" the employer represented that each year's pay credit and the associated interest credits accrue in that plan year. "However, the actual mechanics of the Plan contradict[ed] this representation" because part of the interest credits were not "actually credited" but were "conditional on the participant electing to leave her balance in the Plan." Id. In this instance, the pay and interest credits that AT&T uses for the purposes of demonstrating compliance are not actually payable to participants like Mr. Noerr at the end of each plan year. As described in the statute and in *Esden,* the 133⅓% rule requires that the annual rates of accrual used in "demonstrating compliance" must be "payable" at the end of each plan year with no restrictions in the "actual mechanics" that "contradict this representation."

AT&T's cash balance design fails the 133⅓% test for a second reason. Under AT&T's design, employees like Donald Noerr only accrue bookkeeping entries for the years during which "wear-away" applies, but in a "later plan year," usually "at about age 60," they finally resume actual

benefit accruals. ¶¶141-43. For example, after going from 1997 to 2002 with zero accruals, Donald Noerr would finally resume earning actual accruals at age 60. ¶147. ERISA §204(b)(1)(B) provides that the "annual rate" of accrual in "any later plan year" cannot exceed 133⅓% of the rate of accrual in any earlier plan year. But here, the rate of benefit accrual in the "later plan years" is "infinitely greater" than the zero accrual rate in effect during the wear-away period. ¶145. To comply with ERISA, the period with no accruals must be modified to offer accruals in each "plan year" that are no less than the required percentage of the accrual rate in any "later plan year."

AT&T's plan design fails the 133⅓% test for a third reason, too. The "Payment of Pensions" provision singles out the "annual rates" of accrual of participants like Mr. Noerr who own rights to subsidized early retirement benefits under the pre-Cash Balance plan. The "annual rates" of accrual under cash balance for both new hires and "younger employees" are "immediately" payable with no restriction. ¶146. But older, longer service employees like Mr. Noerr are saddled with a restriction which means their cash balance pay credits–although nominally equal to those of younger employees and new hires--are actually payable only if they give up most of the value of the early retirement benefits they earned before the change. ¶¶181-82. This sets up two different classifications of employees for purposes of accruals: Treasury Regulation 1.411(b)-1(a), 26 C.F.R. 1.411(b)-1(a), provides that a plan sponsor cannot evade the accrual requirements by setting up different accrual rules for different classifications of employees.

The remedy for the 133⅓% rule violations is to remove the condition on payment that keeps the Plan from complying with the accrual test, or, put another way, to require the Plan sponsor to fill in the intermediate plan years with non-contingent accruals that satisfy the 133⅓% rule and are actually payable on the same basis to all participants.

IV. AT&T's 6% per year reduction for commencement of benefits before age 55 does not offer the present value of the subsidized age 55 annuity

Judge Bassler's October 17, 2002 opinion summarizes Plaintiffs' claim about the 6% per year reduction that AT&T applied to retirements before age 55: Plaintiffs claim that a 6% per year reduction has an "excessive nature" when applied to retirements before age 55. Slip Op at 35 n.15.

A. AT&T's 6% per year reduction factor is excessive actuarially

The relevant facts are set forth in ¶¶154-169 of Plaintiffs' Statement of Undisputed Facts. Briefly summarized, the October 2000 Plan document provides at Section 4.06(a)(ii)(A)(2) for a 6% per year reduction of the pension payable at the early retirement age of fifty-five, if the pension is commenced before that age. ¶154-55. Mr. Poulin's expert report states that while a 6% early retirement reduction is common for retirements between ages 60 and 65, and to a lesser extent between ages 55 and 60, this reduction factor is not applied before age 55, because it is actuarially excessive at those ages. ¶156-57 and 160-63. Mr. Poulin found that rather than disclose that its reduction factor was excessive, AT&T made inaccurate representations about the reductions, telling participants that the "overall value" of their benefits remained the "same" even if they commence benefits before age 55. ¶164-65. Neither AT&T nor its actuarial expert disagreed with Mr. Poulin's analysis. ¶¶158-59 and 166.

The class list prepared by AT&T shows that since 1997, 15,116 participants have commenced benefits before age 52, and 11,243 at or before age 49. All of these participants were subject to excessive reductions. ¶168. For example, while AT&T's 6% per year reduction reduced a $1,000 per month pension payable at age 55 down to $100 per month at age 40 (15 years of reduction x 6% = 90%), a reasonable actuarial reduction would have left the retirement benefits at

between $390 and $550 per month. ¶161.

B. The applicable law and remedies

Treasury Regulation 1.411(a)-11(a)(2) provides that when an employer offers a distribution option to a "subsidized early retirement benefit," it must provide at least the present value of that benefit. In *Costantino v. TRW*, 13 F.3d 969, 978-80 (6th Cir. 1994), the Sixth Circuit applied 1.411(a)-11(a)(2) to hold that when TRW offered a lump sum distribution as an option to a subsidized early retirement benefit, TRW's offer had to include the actuarial value of the subsidized benefit. The Sixth Circuit ruled that the regulation "treats subsidized benefits as if they were accrued benefits" "for the sole purpose of limiting an employer's ability to distribute benefits without appropriately calculating the value of any subsidies the employer offers." 13 F.3d at 979.[7]

In essence, the regulations prohibit an ERISA plan from testing a participant's preference for cash or a more immediate commencement of benefits by offering a distribution option to a subsidized early retirement benefit that is worth less than the present value of the subsidized benefit. Rather than comply with the regulations and live up to the fiduciary standard of duty, AT&T induced participants to give up part of the present value of their undiscounted age 55 benefits in exchange for earlier commencements of their benefits. This violates 26 C.F.R. 1.411(a)-11(a)(2).

V. AT&T's SPD did not disclose the adverse features of cash balance to participants as required by the statute and its fiduciary duties

AT&T has violated ERISA §102, 29 U.S.C. §1022, by not understandably disclosing the adverse features of cash balance in the Summary Plan Description (SPD), including, inter alia, those

[7] In *Medeika v. Southern New England Telephone Co.,* Civ. 97-1123 (March 31, 1999), Judge Squatrito in the District of Connecticut also held that the value of early retirement benefits must be included in an optional lump sum form when the Plan document provides that the optional benefit is based on the subsidized early retirement benefit. Slip Op. at 13-14 (attached as Ex. 85).

that "cause older participants to earn no additional benefits beyond those already earned" for up to 13 years. As this Court previously stated, the allegations in the amended Complaint could, if true, "clearly show that Defendant did not disclose features "in a manner calculated to be understood by the average plan participant"." Slip Op. at 5-6.

A. AT&T omitted disclosure of the "bad parts" in the SPD and earlier brochures in order to "sell cash balance"

The relevant facts are set forth in ¶¶170-228 of Plaintiffs' Statement of Undisputed Facts. Everyone agrees that without the assistance of the Plan administrator, or an independent actuary like Mr. Poulin, it is very difficult for participants in a cash balance conversion to understand whether the conversion reduces benefits, and, if so, in what respects. ¶170.

Plaintiffs' actuarial expert, Mr. Poulin, analyzed the circumstances that cause participants to lose benefits that they might otherwise reasonably expect to receive after the cash balance conversion. He identified the following features: (a) the rate of future benefit accruals is significantly lower, with further drops after age 55; (b) the initial cash balance accounts often represent less than one-half of the value of the participant's previously accrued benefits at age 55; (c) the conversion factors used to establish those initial account balances favored younger employees over older employees; and (d) by establishing the initial account balances at as low as one-half of the value of previously-earned benefits and then providing that participants can receive future cash balance accruals only in conjunction with those initial account balances, AT&T created up to 13 year wear-aways during which participants earned no additional benefits. ¶¶173-84.[8]

Plaintiffs asked their communications expert, Professor James Stratman, to analyze what the

[8] Mr. Poulin also identified losses associated with the Plan's benefit options, which are discussed in Section VI of this brief.

SPD disclosed about these circumstances. Professor Stratman was also asked to analyze what the SPD disclosed about the changes to the plan's early retirement schedule, which previously offered a valuable unreduced annuity beginning at age 55. Professor Stratman, a published expert on SPD disclosures, concluded not only that the SPD and precursor brochures failed to adequately explain any of these circumstances, but they actually misled participants as to some of them, e.g., led them to believe that the initial cash balance account was based on the full value of their undiscounted age 55 benefits. ¶¶185-193. AT&T and its communications expert did not contest any of Professor Stratman's findings about the disclosures that were provided to employees. ¶¶214-219.

AT&T was on notice, moreover, that the employees wanted AT&T to disclose the kind of information that Mr. Poulin identified. HR Leaders, focus groups, and individual employees all requested that AT&T offer comparisons showing whether cash balance "reduces benefits" and explaining other features of the cash balance conversion, such as the actuarial basis for the conversion factors. ¶¶104-5 and 202-5. But AT&T refused to disclose the "comparisons" or other "bad parts" of the conversion in order to "sell cash balance." ¶¶106-12. The "large" differences between the Special Update and the opening account balances–with opening balances often representing only "45%" of the value of the Special Update--were hidden. ¶118–20, 123, 209. The fact that the conversion factors had "no true actuarial basis" was "secret." ¶¶203-5. The Plaintiffs' and the Defendants' experts agree that if AT&T wanted to disclose the "bad parts" to employees, it would not have been technically difficult to do so. ¶¶220-22.

In June 1998, a special transfer of assets was arranged between ASA, the benefits consulting subsidiary that was primarily responsible for designing the cash balance conversion, and the AT&T-MPP. This transfer allowed the ASA employees, who all had been participants in the Plan, to receive

special "opening account balances" that were between 200% and 400% of those offered to other AT&T employees. ¶211.[9] Magistrate Judge Hedges found that the "more attractive terms" offered to the ASA employees are relevant to "how disadvantageous this new formula was, how disadvantageous defendants believed it to be, and what defendants' duties of disclosure were in light of these facts." Opinion and Order entered May 20, 2004, at 3; see also ¶213.

Compounding the inadequate disclosures in the SPD, AT&T distributed the SPDs by bulk rate mail to save money – even though bulk mail is notoriously unreliable and less likely to be read, as noted by Professor Stratman. ¶227. Although ERISA requires the maintenance of records about the number of returns and misdeliveries of the SPDs, as well as proof of re-mailing, AT&T's mailer could not find locate any of these records pursuant to a subpoena and could not explain their absence. ¶228. As a result of the use of bulk mail, two of the four named Plaintiffs failed to receive the SPD in January 1998. Only three of the ten class members who were deposed by AT&T testified that they received it in the mail. ¶225. An ad hoc poll of class members on the Internet indicates that 34% of the participants did not even receive the SPD. ¶226.

B. SPDs must "clearly identify" the circumstances that cause losses in benefits that participants reasonably expect

As with the securities laws, ERISA substitutes a philosophy of full disclosure for the philosophy of caveat emptor. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972); *Teamsters v. Daniel*, 439 U.S. 551, 570 (1979) ("Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA"). "Adequate disclosure to employees is one of ERISA's major purposes." *Burstein v. Ret. Acct. Plan*

[9] This transaction was unlawful under ERISA because it gave extra benefits to a "party-in-interest" that were unavailable to other participants. ¶212.

for Allegheny Health Ed. Res. Fdn., 334 F.3d 365, 378 (3d Cir. 2003), relying on *Barker v Ceridian Corp.*, 122 F3d 628, 633 (8th Cir 1997). The "primary" instrument for this disclosure is the SPD. *Burstein*, supra, 334 F.3d at 379. The SPD must "be written in a manner calculated to be understood by the average plan participant." 29 U.S.C. §1022(a) and 29 C.F.R. 2520.102-2(a).

As with the Section 204(h) notice, it is the Plan administrator's responsibility to prepare an understandable and complete SPD. 29 C.F.R. 2520.102-2(a). The responsibility for preparing the SPD is thus a fiduciary duty with the highest duties of loyalty and honesty to the beneficiaries. See, e.g., *Glaziers*, supra, 93 F.3d at 1181. A Plan administrator has a special duty to offer "complete and accurate" disclosures about provisions that are "confusing" or "likely to be misunderstood." *Harte v. Bethlehem Steel Corp.*, supra, 214 F.3d at 448 and 452-3; see also *In re Unisys ERISA Litig.*, 57 F.3d 1255, 1264 (3d Cir. 1995) (recognizing "employer's duty, as an ERISA fiduciary, not to misinform employees through ... incomplete, inconsistent, or contradictory disclosures").

The Third Circuit's decision in *Burstein*, supra, was the first appeals court decision to address disclosures about a cash balance conversion. In *Burstein,* the fiduciaries were aware of the participants' misunderstanding as to the scope of their rights to retirement benefits. 334 F.3d at 386. But the disclosures "convey[ed] the impression" that each participant's benefits were vested and fully funded after the conversion without disclosing that there actually were restrictions on both vesting and funding. The Third Circuit ruled that the disclosures must cover "unquestionably material" information and must be "transparent, accurate, and comprehensive." 334 F.3d at 378..

As *Burstein* indicates, the SPD regulations focus on the clear identification of exceptions and other limitations to a Plan's offer of benefits. The SPD is required to include a "statement clearly identifying circumstances which may result in ... denial, loss, forfeiture or suspension of benefits that

a participant or beneficiary might ... reasonably expect the plan to provide ....” 29 C.F.R. 2520.102-3(l) (emph. added); see also 29 U.S.C. §1022(b). This description must be “written in a manner calculated to be understood by the average plan participant.” 29 C.F.R. 2502.102-2(a). “Any description of exceptions, limitations, reductions, and other restrictions of plan benefits shall not be minimized, rendered obscure, or otherwise made to appear unimportant. The advantages and disadvantages of the plan shall be presented without either exaggerating the benefits or minimizing the limitations.” 29 C.F.R. 2520.102-2(b); see also *Layaou v. Xerox Corp.*, 238 F.3d 205, 209 (2d Cir. 2001). If descriptions of restrictive plan provisions are not disclosed “in close conjunction with the description or summary” of benefits, “clear cross-references” are required. 29 C.F.R. 2520.102(a) and (b); see also *Burke v. Kodak Retirement Income Plan,* 336 F.3d. 103, 110-11 (2d Cir. 2003), *cert. denied*, 124 S.Ct. 1046 (2004) (description of survivor’s benefits did not cross-reference a significant requirement to actually receive those benefits).

SPD’s must be distributed in a manner that ensures “actual receipt” by each participant. 29 C.F.R. 2520.104b-1(b). In *Leyda v. Allied Signal, Inc.*, 322 F.3d 199, 201-3 and 208-9 (2d Cir. 2003), a participant did not receive an SPD that disclosed a reduction in life insurance. Even though the company used several different methods for distribution, its “distribution procedures could easily have missed some participants” whereas ERISA requires the SPD to reach “each” participant.

The Department of Labor’s regulations allow bulk mail (also known as third-class mail) to be used for the delivery of SPDs but only if certain standards are met. DOL regulations require that “return and forwarding postage is guaranteed” and that “any material ... which is returned with an address correction shall be sent again by first-class mail or personally delivered to the participant at his or her worksite.” 29 C.F.R. 2520.104b-1(b). ERISA §107, 29 U.S.C. §1027, requires that records

be maintained to verify compliance with the disclosure requirements. See, e.g., *Medoy v. Warnaco Employees Long Term Disability Ins. Plan*, 43 F.S.2d 303, 311 (S.D.N.Y. 1999).

C. Analysis and remedies

AT&T informed its employees that the "best features" of the existing plan were being preserved and that their benefits "will grow steadily" under cash balance. ¶¶185 and 191. Comparative information was suppressed and the restrictions on the actual payment of the cash balance plan's pay and interest credits were "minimized, rendered obscure or otherwise made to appear unimportant." See 29 C.F.R. 2520.102-2(b). As mentioned, employees repeatedly asked AT&T to compare the "old vs. new" and disclose if cash balance "reduce[s] benefits." ¶¶104-5 and 202-4. Despite those requests and the fiduciary duty recognized in *Bixler*, *Harte*, and *Unisys,* AT&T did not disclose the benefit reductions in the SPD or elsewhere.

As described above, the record shows that AT&T suppressed information about (1) the 15% or more reductions in the rates of future accruals, (2) the "large" discrepancies between the opening balances and the value of the age 55 benefits, and (3) the fact that the conversion factors had "no true actuarial basis." AT&T led employees to believe that the opening account balances were based on the "undiscounted age 55 benefits" and that the accounts were going to grow "steadily" with the addition of pay and interest credits. Analogous to *Layaou v. Xerox Corp.*, 238 F.3d 205, 210-11 (2d Cir.2001), where "one single sentence" indicated that benefits "may also be reduced" but did not explain the mandatory nature or extent of an offset of prior benefits, a lone sentence appears in AT&T's SPD which states that "there may be instances where the benefits available before Normal Retirement Age under the Plan's prior pay base averaging period formulas ... are greater than the benefits available through the Cash Balance Account." This sentence does not explain that AT&T's

conversion factors are intentionally designed to make "the benefits available through Cash Balance Account" lower than the prior pay base benefits in "97%" of the cases and in many instances offer only "45%" of the prior benefit , ¶118, thereby producing wear-away periods extending up to 13 years. The SPD also does not explain that the Plan document was being revised to provide that future benefit accruals were no longer "plus" the pre-cash balance benefits. The SPD's relatively-detailed description of the pay and interest credits completely fails to disclose, or cross-reference, any limitations in a manner reasonably calculated to communicate that the pay and interest credits will never be more than accounting entries for tens of thousands of participants.

AT&T's SPD also failed to describe the new schedule of early retirement reduction factors under cash balance--even though the change from an undiscounted early retirement benefit was described internally as "the most significant cost saving aspect" of the entire package. ¶¶187. This was a material omission in violation of ERISA's disclosure rules, too. See *Baker v. Lukens Steel*, 793 F.2d 509, 511-12 (3d Cir. 1986) (elimination of special early retirement benefit is material change requiring disclosure), *Copeland v. Geddes Federal Sav.*, 62 F.S.2d 673, 678 (N.D.N.Y. 1999) ("specific early retirement reduction factors" that were eliminated were not identified), *Normann v. Amphenol Corp*., 956 F.S. 158, 165-66 (N.D.N.Y. 1997) (disclosure did not "mention the specific early retirement reduction factors" company had adopted and participants cannot be "expected to equate" reference to "standard early retirement reductions" with the "actual reductions").

The insufficient disclosures were compounded by AT&T's use of bulk mail to distribute the SPDs. AT&T's use of bulk mail to effect relatively insignificant cost savings showed that "actual receipt" of the SPD by "each" participant was not a priority. Because AT&T neglected to keep records of the steps taken to ensure actual receipt as ERISA mandates, the full extent of the delivery

problems cannot be ascertained, but an inference must be drawn that inadequate distribution compounded inadequate disclosures.

Burstein holds that participants are entitled to appropriate equitable relief for SPD violations without establishing reliance on an individual-by-individual basis: "[J]ust as a court's enforcement of a contract generally does not require proof that the parties to the contract actually read, and therefore relied upon, the particular terms of the contract, we are persuaded that enforcement of an SPD's terms under a claim for plan benefits does not require a showing of reliance." 334 F.3d at 381. Enforcement is instead based on showing that the SPD conflicts with the Plan language by inadequately disclosing a limitation or other restriction. In *Burstein*, the SPD "convey[ed] the impression" that cash balance benefits were vested and fully funded when there were actually limitations. Most other SPD cases also involve inadequate disclosures of benefit limitations or changes to benefits that participants previously enjoyed.[10]

In contrast to SPD violations, certain kinds of claims for breach of fiduciary duty require proof of individual detrimental reliance. See *Burstein*, 334 F.3d at 387. However, reliance is presumed when cases involve material, classwide non-disclosures. *Newton v. Merrill Lynch*, 259 F.3d 154, 176-77 (3d Cir. 2001), holds that "[p]resuming reliance class-wide is proper when the material non-disclosure is part of a common course of action." "We will not require each plaintiff to prove he relied on a practice which defendants did not affirmatively disclose." Consistent with

[10] See, e.g., *Layaou*, supra, 238 F.3d at 210-11 (inadequate disclosure of offset of prior benefits); *Burke*, supra, 336 F.3d at 110-11 (no cross-reference to affidavit needed to receive survivor benefits); *Chambless v. Masters Mates & Pilots Pension Plan*, 772 F.2d 1032, 1040 (2d Cir. 1985), *cert. denied*, 475 U.S. 1012 (1986) (inadequate disclosure of "full import" of plan amendment); *Hooven v. Exxon Mobil*, 2004 U.S. Dist. LEXIS 5484 (E.D.Pa. Mar. 31, 2004) (omission of ineligibility condition); *Normann v. Amphenol*, supra, 956 F.S. at 165-66 (inadequate disclosure of changes to early retirement reduction factors and "actual reductions" applicable after the changes).

Newton, *Bixler, Harte, Unisys, Jordan,* and *Glaziers* all hold that a breach of fiduciary duty is established when it is shown that a fiduciary knew about or should have foreseen the employees' need for material information, but failed to disclose it. See *Bixler*, supra, 12 F.3d at 1300 (failure to disclose facts which the fiduciary could see the beneficiary did not know but needed to know); *Harte*, supra, 214 F.3d at 452-3 (breach of fiduciary duty when plan administrator fails to adequately disclose plan terms that are "confusing" or "likely to be misunderstood"); *In re Unisys*, supra, 57 F.3d at 1265 n.15 and 1266 ("trustees had to know that their silence might cause harm"); *Jordan v. Federal Express*, 116 F.3d 1005, 1015-17 (3d Cir. 1997) (fiduciary's failure to inform "constitute[s] a material omission" if "there is a substantial likelihood that it will mislead a reasonable employee in making an adequately informed retirement decision"); *Glaziers*, supra, 93 F.3d at 1181-2 (fiduciary must communicate information "visible to its practiced eye" that is in the "best interest" of beneficiaries to disclose). In this instance, the repeated requests for information put AT&T on notice that participants did not have the information they needed to make informed employment and retirement decisions. AT&T's internal documents and testimony show that responsive information about the "bad parts" of cash balance was intentionally suppressed.

What could managers have done with full disclosures, e.g., about reduced future rates, the basis for the conversion factors, and how the initial cash balances compared with the value of their Special Update? The Third Circuit provides this answer: "Full disclosure ... permits employees to bargain further or seek other employment if they are dissatisfied with their benefits." *Hamilton v. Air Jamaica,* 945 F.2d 74, 78 (3d Cir. 1991). If AT&T fulfilled its fiduciary duty to honestly tell employees that their pension rates were being cut 15% or more, that the initial Cash Balance equaled only "45%" of the value of their Special Update, and that the new cash balance accruals were merely

bookkeeping entries until the 55% difference was made up, the managers could have bargained for increased compensation or benefits in the ways salaried employees negotiate in a mobile market economy, including complaining to HR and their supervisors and threatening to seek other employment and take their skills and business contacts elsewhere.

After union representatives learned in December 1997 that the conversion factors used for the management employees had "no true actuarial basis," they were able to obtain more favorable conversion factors and grandfather provisions that eliminated practically any wear-away. ¶¶205-206. Armed with complete information about the changes, the ASA consultants were also able to virtually exempt themselves from the "bad parts" of the cash balance conversion by obtaining opening balances equal to between 200% and 400% of the balances applicable to other participants. ¶211. Disclosure would have further revealed the compliance issues (e.g., with ERISA's 133⅓% rule) and the issues with age discrimination (e.g., that the wear-away provision was designed so that "younger employees" receive their benefits "immediately"). See *Smith v. City of Jackson*, 351 F.3d 183, 193 n.12 (5th Cir. 2003), *cert. granted*, 124 S.Ct. 1724 (March 29, 2004) (disclosures "help to alert ... employees to the possibility that they might have suffered disparate treatment based on age").

Absent plan-wide modifications to the bad parts of the cash balance provisions, employees could have pursued individual courses of action to better protect themselves. For example, with full disclosures, managers could negotiate individually for changes in their pay, incentive compensation, or benefits or make plans to seek work elsewhere. The movement would not always have been in the direction of leaving earlier: Employees who were close to eligibility for other benefits might have used the disclosures to insist on slight delays in their separation dates. For example, one of the class members deposed in this case was less than 30 days from eligibility for full retiree health benefits.

Under *Burstein*, the appropriate equitable relief for AT&T's deliberately inadequate disclosures is to continue the features of the prior formula whose elimination or modification was not disclosed. This is consistent with the appropriate remedies for AT&T's retroactive plan amendments and the failure to provide Section 204(h) notice of the reductions.

VI. The SPD and election materials do not explain the unequal values of benefit options

When a Plan offers benefit options with unequal values, participants face a loss of part of their benefits if they make the wrong decision. Judge Bassler summarized the class' claim that AT&T "induced employees to take an earlier pension for a lesser amount of money than they otherwise would" without explaining the relative values. Slip Op dated Oct. 17, 2002, at 36 n.15.

A. The "relative values" of benefit options have not been disclosed

The pertinent facts are described in ¶¶229-252 of Plaintiffs' Statement of Undisputed Facts. After reviewing AT&T's Pension Payment Election Forms, Mr. Poulin determined that participants and their spouses were being asked to elect cash payments and give up lifetime annuity benefits with substantially higher values. While participants were given four choices as to payment, they were not told that the third and fourth options were often "clearly less valuable." ¶229. For example, Edward O'Brien would have received 38% more by electing the first or second options, as opposed to the third or fourth. Without sufficient information, he chose the fourth. Ms. Bonny Berger was not even presented with her most valuable option, thereby losing 42.5% of the value of her pension. ¶¶230-33. AT&T and its experts have not contested Mr. Poulin's analysis of the relative values. ¶¶236-38 and 240. The documents show that AT&T knew that it was offering "clearly less valuable" options to employees who lacked sufficient information to understand the relative values. ¶¶235 and 239.

Professor Stratman found that "[t]he SPD and benefit election materials consistently hide the

pitfalls in benefit options, leading employees to believe that financially unequal options have the same overall value." ¶234. Instead of disclosing the unequal values, AT&T offered assurances that employees would always receive "the highest benefit that applies to you." ¶¶242-244. Professor Stratman determined that understandable disclosures would not be difficult and offered examples of language that AT&T had already used in other contexts. ¶¶249-50. AT&T's communications expert did not contest Professor Stratman's findings. ¶251. AT&T's only response to this claim has been to take the sophistical position that "value" cannot be disclosed because it always depends on individual circumstances, e.g., state of health. ¶¶245 and 247-48. But AT&T has repeatedly shown its ability to make representations about "value," ¶246, and the regulations indisputably require disclosures of relative values in market terms.

The class list that AT&T prepared in response to an Order from Magistrate Judge Hedges identifies 24,405 participants like Mr. Engers, Mr. O'Brien, and Ms. Berger who made benefit elections without adequate disclosures about the relative values of the options. ¶241. Although some such as Mr. Engers selected the most valuable option anyway, thousands of others, like Mr. O'Brien and Ms. Berger, have not.

B. Fiduciaries have a duty to convey complete information about benefit options

The principle that fiduciaries have a duty to convey complete and accurate information about benefit options predates ERISA: In *Gediman v. Anheuser-Busch,* 299 F.2d 537, 545 (2d Cir. 1962), Judge Friendly wrote that an explanation that a benefit "would not be as much as" another does "not convey to the ordinarily unlearned pensioner that on this account it would be only 42% as much." In *Bixler,* supra, 12 F.3d at 1300-03, the Third Circuit held that a fiduciary has a duty to help participant's spouse to find her best options, even if she did not ask the precise technical question. The administrator breached its fiduciary duty to provide "complete and accurate information that was

material" to the benefits that were available to the spouse and her husband. See also *Jordan,* supra, 116 F.3d at 1014-7 (even if Treasury regulations do not specifically mandate disclosure that benefit elections are irrevocable, fiduciary has duty to inform participants of material features); *Genter v. Acme Scale & Supply*, 776 F.2d 1180, 1185 (3d Cir. 1985) (option to increase life insurance mid-year was "made known to a few," but there was "never any information" for all participants).

The SPD regulations require an understandable explanation of the circumstances that can cause a participant to lose part of the value of his or her benefits. 29 C.F.R. 2520.102–2(a) and (b) and 2520.102-3(l). When defined benefit distribution options are at issue, another regulation makes the disclosure obligation still clearer. Before a participant and his/her spouse can "consent" to an "immediate distribution" such as a cash payment option, and give up a higher-valued annuity, a Treasury regulation specifically requires the plan to offer "sufficient" information "to explain the relative value of the optional forms of benefit available under the plan (e.g., the extent to which optional forms are subsidized relative to the normal form of benefit...)." 26 C.F.R. 1.401(a)-20, Q&A 36.[11] Related regulations provide that "no consent is valid" unless both the participant and spouse receive an "explanation of the relative values" of benefit options. 26 C.F.R. 1.417(e)-1(b)(2)(i).

C. Analysis and remedies

AT&T's failure to disclose the relative values of benefit options violates the fiduciary duty to disclose, the SPD rules, and the Treasury regulation on consent for immediate distributions. There is no exception to the disclosure obligation for philosophical differences about "value." Moreover, AT&T actually had a non-philosophical interest in not offering disclosures: It achieved an estimated

[11] The relative value regulation was issued under ERISA §§203(e) and 205(g), 29 U.S.C. §§1053(e) and 1055(g), and parallel provisions in Internal Revenue Code §417(e), 26 U.S.C. §417(e). New regulations amplifying the disclosure requirements were finalized on December 17, 2003. 68 F.R. 70141. Plaintiff does not contend the new rules are retroactive, but they highlight the emptiness of AT&T's argument that it is impractical to disclose "relative values."

AT&T actually had a non-philosophical interest in not offering disclosures: It achieved an estimated $400 million cost savings by allowing participants to choose "clearly less valuable" options. ¶62.

The remedies for AT&T's failure to disclose the relative values of benefit options flow from the regulations: "No consent is valid" unless a participant is given an "explanation of the relative values" of the optional benefit forms. 26 C.F.R. 1.417(e)-1(b)(2)(i). Employees like Ed O'Brien and Bonny Berger chose lower amounts without the explanations that the rules mandate. With disclosure, they could have made different elections, including to defer commencement to closer to age 55.

Conclusion

For the foregoing reasons, the named Plaintiffs on behalf of themselves and over 45,000 current and former AT&T employees respectfully request that the Court enter an Order granting their motion for summary judgment.

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Respectfully submitted

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