PHILLIP C. ENGERS, WARREN J. MCFALL DONALD G. NOERR, and GERALD SMIT, individually and on behalf of all others similarly situated,
Plaintiffs,

vs.

AT&T and AT&T MANAGEMENT PENSION PLAN,
Defendants.

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

C.A. No. 98-CV-3660 (JLL)

PLAINTIFFS' LOCAL CIVIL RULE 56.1 STATEMENT OF UNDISPUTED MATERIAL FACTS

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Plaintiffs' Statement of Undisputed Material Facts

Pursuant to Local Civil Rule 56.1 of the Local Civil Rules of the United States District Court for the District of New Jersey and Rule 56 of the Federal Rules of Civil Procedure, Plaintiffs respectfully submit the following statement of material facts as to which there does not exist a genuine issue for trial[1]:

I. Introduction

A. The AT&T Management Pension Plan

1. The AT&T Management Pension Plan was created in 1980 as a result of the court-ordered break-up of the former Bell System. Before 1980, the AT&T Management Pension Plan was a final average pay plan. This means pension benefits were based on the average compensation of plan participants in the years immediately preceding their retirement. Poulin Rpt. ¶ 29.

2. In 1980, the AT&T Management Pension Plan adopted a modified career average pay formula. Under this formula, benefits are based on average pay in a designated window period, with periodic updates or movements of that window. Between 1980 and 1997, AT&T made seven adjustments or updates to the pay window at intervals of every three years or less. Each update

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[1] The Reports of the Plaintiffs' actuarial and communications experts and the Defendants' actuarial and communications experts are contained in Volume I of the Appendix and are referenced by the expert's name followed by "Rpt." Because these Reports are referenced so often and have exhibits attached, they are referenced to by name rather than their Exhibit number. Exhibits attached to the experts' reports are also referenced by the name of the expert and the exhibit number used in his or her report, e.g., "Poulin Rpt. Ex K."

References to the last name of a deponent followed by "Depo" refer to extracts of deposition transcripts annexed as exhibits in Volume VI of the Appendix. For convenience, the Tab number appears after the word Depo, e.g., Morgan Depo (90) at XX refers to the page number in the extracts of the deposition of Kenneth Morgan which are under Tab 90. All other exhibits are simply referred to by the Exhibit numbers in the accompanying Appendix.

resulted in average benefit increases of over 10%. Without an update, the fixed pay base causes benefits to fall behind in relation to employees' current salary. Poulin Rpt. ¶ 29 and Poulin Ex. K.

3. Until the end of 1997, the AT&T Management Pension Plan offered retirement benefits equal to participants' average compensation during the pay base averaging period multiplied by their number of years of credited service times a benefit accrual percentage of 1.6%. At the start of 1997, the Plan provided benefits equal to an average of a participant's average compensation during 1987-92 multiplied by years of credited service through the end of 1992 times 1.6%. For years of service after 1992, the benefit accrual rate was 1.6% of each year's annual compensation. Poulin Rpt. Ex. K.

4. As described further below, AT&T's adopted resolutions concerning two sets of amendments to the Plan in or about April 1997: (1) the "Special Update" amendments, which were effective January 1, 1997, and (2) the "Cash Balance" amendments, which were effective January 1, 1998. In essence, the Special Update amendments were improvements, while the Cash Balance amendments were generally reductions.

5. AT&T estimated that the 1997 Special Update amendments offered an 18-20% increase in pension amounts (as compared to a normal update to the pay base period of 9-11%). Ex. 33 at 35348; see also Stratman Rpt. Ex. 1 and Poulin Rpt. Ex. K.

6. AT&T estimated that the cash balance features which became effective January 1, 1998 would result in $1.5 billion in future cost savings. Ex. 7. A subsequent memo increased this estimate by $400 million because a provision on benefit options "was not clear to us." Stratman Rpt Ex. 13.

7. Form 5500 Annual Reports show that AT&T made no contributions to the AT&T Management Pension Plan in the years from 1996 to 2002 (which is the latest available year). Ex. 50.

8. AT&T serves as both the Plan sponsor and the Plan administrator for the AT&T

Management Pension Plan. Ex. 5 (Section 2.32). As the Plan administrator, AT&T is considered a fiduciary under ERISA. Byrnes Depo (92) at 178-79.

9. ASA was a benefits consulting subsidiary of AT&T that provided administrative and consulting services, including legal services, for the AT&T Management Pension Plan. ASA was spun off from AT&T in June 1998 and later acquired by AON. Until the end of June 1998, employees of ASA participated in the AT&T Management Pension Plan; some ASA employees held "dual" positions as employees of the parent AT&T and the subsidiary. See, e.g., Gulotta Depo (93) at 29-30; Morgan Depo (90) at 13. For its consulting and administrative services in connection with the cash balance conversion, ASA was paid over $8 million from the trust assets of the AT&T Management Pension Plan. Ex. 37. ASA, now a part of AON, continues to have large, long-term contracts with AT&T to provide consulting and administrative services, including services in connection with the AT&T Management Pension Plan. Gulotta Depo (94) in Peterson at 7; Morgan Depo (90) at 7-8; and Ex. 23 at Section 6.3.

10. In response to an Order from Magistrate Judge Hedges, AT&T supplied a class list that identifies over 45,600 class members. Anderson Decl.¶ 3.

B. The Plan's amendment procedure

11. As ERISA Section 402(b)(3) requires, the AT&T Management Pension Plan (AT&TMPP) contains a procedure for amending the Plan document. Section 10.01 of the Plan document, entitled Power to Amend, specifies:

> "The board of directors of AT&T or its delegate, may from time to time make changes in the Plan as set forth in this document, or terminate such Plan, but such changes or termination shall not affect the rights of any individual, without his or her consent, to any benefit or pension to which he or she may have previously become entitled hereunder."

Exs. 5 and 6.

12. AT&T maintains that in a closed meeting on the morning of April 16, 1997, the Compensation and Employee Benefits Committee (CEBC) of AT&T's Board of Directors adopted resolutions to update the Pension Plan's pay base formula effective at the start of 1997 and establish most of the features for a "new" cash balance arrangement and transition provisions to be effective January 1, 1998. Ex. 13. AT&T also maintains that the Board of Directors (the "Board") approved the CEBC resolutions the same afternoon. McHenry Depo (98) at 39-40.

13. There is an issue of fact about whether the written resolutions were actually presented to either the CEBC or Board on April 16, 1997. Ex. 12, which was identified in a letter from Defendants' counsel and at Ambassador McHenry's deposition, as the "material that was in the binders which were prepared for the Compensation and Employee Benefits Committee on April 16, 1997," did <u>not</u> contain any resolutions. See McHenry Depo (98) at 33 and 37-40 and Ex. 12. Drafts of the resolutions were still being circulated for final revisions in August 1997. Ex. 11. Attorney Kenneth Morgan suggested that it is possible that the resolutions were actually ratified by the CEBC and the Board several months after the April meeting. Morgan Depo (90) 190-96.

14. The Board Resolutions provided in pertinent part:

> RESOLVED: that, effective January 1, 1998, the AT&TMPP be amended to provide that, for each eligible employee who is on the active roll of a participating company on January 1,1988, the initial credit to the participant's cash balance account be determined by multiplying the participant's monthly special update benefit by the applicable conversion factor set forth in Attachment 1 based on the participant's attained age as of December 31, 1996.
>
> RESOLVED: that effective January 1, 1998, the AT&TMPP be amended to provide that each participant have credited to his or her cash balance account . . . an annual pay credit in an amount equal to the sum of (1) the participant's eligible compensation multiplied by the applicable percentage specified in Attachment 2 plus (2) his or her eligible compensation

above the Social Security wage base multiplied by the applicable percentage specified in Attachment 2 . . .

> RESOLVED: that effective January 1, 1998, the AT&TMPP be amended to provide that each individual have credited to his or her cash balance account, effective December 31, 1998 and each December 31 thereafter . . . an interest credit in an amount determined by multiplying his or her cash balance account as of the first day of that year by the effective annual interest rate, which shall equal a base rate of four percent and, for 1998 and 1999, a bonus rate of three percent;
>
> RESOLVED: that, effective January 1, 1998, the AT&TMPP be amended to provide that, for participants who terminate employment on or after January 1, 1998, pensions with respect to cash balance accounts be payable in the form of (1) a single life annuity, (2) a joint and 50% survivor annuity, (3) a joint and 100% survivor annuity, or (4) a cash payment option.
>
> RESOLVED: that, notwithstanding anything in the prior resolutions to the contrary, the accrued benefit of each participant in the AT&TMPP shall not be less than the participant's accrued benefit under the AT&TMPP as of July 31, 1997 (the "protected benefit").

Ex. 13 at 5607-10 and 5615.

15. The Board's resolutions delegate responsibility to the Senior Vice-President of Compensation and Benefits (or his delegate) to:

> "(1) incorporate appropriate language in the AT&TMPP . . . to reflect properly the intent of the foregoing resolutions;
>
> (2) make such other administrative amendments necessary or appropriate to implement the foregoing resolutions and that are consistent with the intent of the cash balance design presented to the Board."

The resolutions also provided that the foregoing amendments are subject to "such other changes as are necessary to comply with any applicable law." Ex. 13 at 5622-24.

16. Subsequent to the Board meeting, AT&T's cash balance implementation team set up two work projects to prepare "necessary or appropriate" amendments for the Senior Vice President to consider. The first work project was to update the Plan documents for the Special Update; the due

date for this project was originally 5/5/97. The second work project was to update the plan documents for cash balance; the original due date for this project was 10/1/97. Ex. 8.

II. The December 19, 1997 Special Update Amendments

17. Under a delegation of authority from AT&T's Senior Vice-President for Compensation and Benefits, Brian Byrnes adopted Special Update amendments on December 19, 1997. Ex. 9.

18. The Special Update Amendments were effective for active participants on January 1, 1997. The amendments updated the average compensation used under the prior formula from the average compensation earned during 1987-92 to average compensation earned during 1994-96. Ex. 9.

19. The Special Update moved the pay base window closer to employees' current salaries, thus bringing benefits up to where they should be based on current pay "not what we made 10 years ago." Engers Depo (112) at 125. A February 1997 presentation showed that AT&T's use of 1.6% of an "87-92 [Pay] Base" produced benefits that ranked in the lower-half of a 50 company ranking–ranking 42nd out of 50 at higher pay levels. Ex. 43 at 12495. AT&T's April presentation to the CEBC recognized that it was "behind" in updating the pay base with "employees anticipating change." Ex. 12 at 34262. See also Wyman Depo (105) at 27-28.

20. The Special Update also offered a credit of an additional year of service for employees with over 20 years of service. Ex. 9. The Plaintiffs' actuarial expert explains that the additional service credit was in lieu of crediting the employees' service in 1997 under the prior formula. Poulin Rpt. ¶ 29.

21. Finally, the Special Update made participants eligible for early retirement benefits without having to "age into" (also known as "grow into") the age and service eligibility requirements

that previously applied to those benefits. Ex. 9.

22. In Judge Bassler's words, "AT&T increased and froze retirement benefits that had already accrued through December 31, 1996. These benefits were calculated and then fixed via a mechanism referred by the parties as the Special Update Formula." The "Special Update Benefit . . . reflects all work performed before 1997." Slip Op dated October 17, 2002 at 18.

III. The October 16, 2000 Cash Balance Amendments

23. As the delegate of the Senior Vice-President, Mr. Byrnes adopted Cash Balance amendments, too, but this did not occur until October 16, 2000. Ex. 5 at 21544. The amendments were retroactively effective to January 1, 1998.

A. AT&T did not make the cash balance amendments available to participants for inspection until October 2000

24. AT&T stamped its April 1997 Board resolutions as "Confidential" and did not treat them as official Plan amendments. See Ex. 13. In filings with Federal agencies responsible for ERISA, AT&T never represented that the Plan document was amended for either Special Update or Cash Balance by the Board resolutions dated April 16, 1997. In response to a requirement that AT&T submit all amendments subsequent to its previous determination letter, AT&T responded that the Plan document as restated on October 16, 2000 includes all of the changes since the last submission and will supply a copy of the amendments on request. AT&T did not offer the April 1997 resolutions as amendments. Ex. 41 (2002 Application response to Line 3b).

25. AT&T's summary plan description ("SPD"), which was distributed in 1998, and brochures about benefits that AT&T distributed in 1997 contained disclaimers warning against reliance on any information in the SPD or brochures that is in conflict with the "terms of the official

Plan documents." Stratman Rpt. Ex. 1 at 4, Ex. 2 at D001370, Ex. 3 at inside cover and Ex. 4 at inside cover. Page 28 of the SPD explains how the official Plan documents with "complete information" can be obtained. Stratman Rpt. Ex. 4.

26. Employees who asked for the official Plan documents were told, however, that the Plan document was not "available." For example, on February 17, 1999, AT&T's Pension Service Center stated in a letter to an attorney that the documentation of the "new" cash balance feature and transition provisions was not available and that the Plan Document reflecting the "new" cash balance amendments was "being revised." Ex. 14. AT&T's Plan administrator offered a similar response in a letter dated 11/10/1999. Ex. 15 at 32153.

27. In response to a request from one of the named Plaintiffs to the Plan administrator, Defendants' counsel intervened and wrote a letter dated July 15, 1999 identifying a November 5, 1997 document signed by the Senior Vice-President as "including the amendments and resolutions concerning the Special Update and Cash Balance features (Tab 6)." Ex. 16. However, the document under this Tab did not contain the amendments adopting any of the principal features of either the Special Update or Cash Balance. AT&T and its counsel have subsequently dropped the contention that the amendments concerning the Cash Balance features are in a document dated November 5, 1997.

28. In August of 1999, AT&T notified employees in a Notice to Interested Parties that it was submitting an "Application for Determination" to the Internal Revenue Service on September 15, 1999. Ex. 10. These Applications are required to include the official Plan documents. Employees must be permitted to inspect and copy the Applications, including the accompanying Plan documents. However, after the Treasury Department announced a freeze on September 15, 1999 on

the issuance of favorable determination letters for cash balance conversions, AT&T decided not to submit its Application.

29. Discovery produced draft Plan documents dated 7/15/1999 and 9/2/1999. Exs. 21 and 22. Those documents were not "finalized"; instead, at least one more draft of the Plan document was prepared before the Plan document was adopted on October 16, 2000. Liedtke Depo (97) at 47-49.

30. On August 4, 2000, Plaintiffs served interrogatories and document requests. After an extension, responses were due on October 20, 2000.

31. The Interrogatories asked AT&T about:

(a) The status of any revision to the Plan document dated October 1, 1996;

(b) Whether the Senior Vice-President had ever adopted amendments to reflect the intent of the cash balance design presented to the Board;

(c) Any respects in which the April 1997 resolutions did not contain all the amendments necessary to implement the cash balance design; and

(d) Identifying any Plan amendments containing cash balance features adopted after April 16, 1997.

AT&T stated that the Plan document had been restated (which actually had only occurred four days before the date of the Answers to Interrogatories) and it identified "administrative amendments" to Cash Balance by the Senior Vice President or his delegate dated November 5, 1997, December 19, 1997 and November 11, 1999. AT&T further contended that the cash balance design was "fully adopted" by the Board on April 16, 1997 and that the April 16, 1997 resolutions contained "all the necessary amendments." Ex. 17, Tab A (Answers to Interrog. No. 18 addressed to the Plan and Interrog. Nos. 8-10 addressed to AT&T).

32. The document requests asked, in numerous ways, for all documents related to the

adoption of the cash balance design presented to the Board. Ex. 17, Tab B (Request Nos. 1-2, 7, 12-13, 16-18, 24-26, and 48). On October 16, 2000, four days before the extended due date for responses, Brian Byrnes, acting as the delegate of AT&T's Senior Vice-President for Compensation and Benefits, approved an amended and restated Plan document with complete provisions for the cash balance features. Ex. 5 at 21544.

33. AT&T has not produced any documents to explain the 3½ year delay in approving necessary or appropriate amendments related to cash balance. In his deposition, Kenneth Morgan, the principal scrivener of the cash balance amendments, could not shed any light on the 3½ year delay. Morgan Depo (90) at 31-36. Mr. Byrnes, AT&T's Rule 30(b)(6) designee on the cash balance amendments (see Ex. 82), testified that other pension activities delayed formalizing the plan language. Byrnes Depo (92) at 71-72.

34. Deposition testimony on July 30, 2003 from Mr. Morgan's associate, Allyson Liedtke, revealed that when the Plan document was "finalized," she "had a temporary clerk shred all of the previous versions that [she] had at that point in time." Liedtke Depo (97) at 14-17. This shredding occurred after Plaintiffs had served document requests for the Plan documents and previous drafts on August 4, 2000. AT&T had objected to those requests on grounds of privilege and on October 3, 2001 and again on November 30, 2001, Magistrate Judge Hedges entered Orders compelling production of draft Plan documents over AT&T's objections.

35. AT&T's plan administration did not operate in a vacuum in the period between January 1, 1998 and October 16, 2000. A software program based on "Business Requirements" for cash balance was placed into effect after January 1, 1998. See Ex. 20. However, AT&T's Board never delegated authority to adopt amendments to the consultants or AT&T employees who prepared the Business

Requirements and the software program.

B. The October 2000 Plan document contains two substantive cash balance rules that the Board did not adopt in 1997

36. The amended Plan document contained rules that were not in the preceding Plan document or any amendment adopted by the AT&T Board of Directors or a duly-authorized delegate.

(1) <u>The "wear-away" rule</u>

37. The rules contained in Section 4.06(a)(ii) on "Payment of Pensions" were not in any amendment adopted by the AT&T Board or a duly authorized delegate. See Ex. 17, Tab A (Ans to Int. No. 10 addressed to AT&T, identifying all Plan amendments adopted after April 16, 1997).

38. In pertinent part, Section 4.06(a)(ii) on "Payment of Pensions" provides that when a benefit is payable "before normal retirement age," payment of the "greater of":

(1) "the Accrued Benefit derived from his or her Cash Balance Account . . . or

(2) the Accrued Benefit determined under the Pay Base Formulas . . ."

discharges both the Plan's obligation to pay the Accrued Benefit determined under the pre-existing Pay Base Formulas for service through August 1, 1997, and any Accrued Benefits earned thereafter. The "Accrued Benefit determined under the Pay Base Formulas" is a frozen benefit. There are no on-going accruals under the Pay Base formulas.

39. Section 4.06(a)(ii) essentially provides that AT&T will only pay the "greater of" the cash balance account or a <u>frozen</u> minimum consisting of the previously-earned Pay Base formula benefits with no increments. Pursuant to this provision, AT&T will <u>not</u> pay cash balance accruals earned beginning in 1998 in addition to a participant's previously-earned Pay Base formula benefits. It will only pay those accruals in conjunction with the opening account balance that AT&T has established

for the participant under cash balance. Expressed as annuities, the opening account balances can be significantly lower than the participant's previously-earned benefits, sometimes equaling only 45% of the latter. Ex. 64.

40. This has been described as a "wear-away" provision. AT&T's Plan document previously contained a "greater of" formulation, but it was in connection with two on-going pay-based formulas which each provided that an employee's benefits are "plus" 1.6% of each succeeding year's compensation. Ex. 6 (Section 4.2(a) and (b)) When a greater of formulation is used with a frozen formula that is higher than the on-going formula, wearaways can result in which participants earn no additional benefits.

41. AT&T designated Donald McHenry, the former United Nations Ambassador under President Carter, to testify on behalf of the CEBC and the full AT&T Board. In his deposition, Ambassador McHenry did not recall authorizing a wear-away or crossover and does not even know what that is. He acknowledged that the April 1997 resolutions were not "self-executing" but instead delegated authority to the Senior Vice-President to adopt necessary or appropriate amendments. McHenry Depo (98) at 75.

42. Thomas Wyman, who chaired the CEBC, testified in the Peterson v. AT&T case before his untimely death at the start of 2003 that the CEBC didn't go over the "back-up slides" one of which contains an indirect indication of crossover, "slide by slide." Wyman Depo (105) in Peterson at 35-36. Mr. Wyman also testified that the crossover point was not a specific factor that the Board looked at. Wyman Depo (105) at 54-57. Presentations to some AT&T executives in February 1997 and July 1997 included a slide about how "younger employees" would start earning cash balance benefits "immediately" while older employees would not. Ex. 43 at 12509 and Ex. 44 at 18298. This

slide was not shown to the Board. See Ex. 12.

43. Brian Byrnes, the delegate who eventually executed the October 16, 2000 amendments, was designated by AT&T to testify under Rule 30(b)(6) on the adoption of the cash balance rules. Mr. Byrnes conceded that the Board resolutions did not contain amendments on wearaway. Byrnes Depo (92) at 90-92. Byrnes testified: “They didn’t say you could. They didn’t say you could not.” Byrnes Depo (92) at 97-98.

44. As AT&T’s designated 30(b)(6) representative, Mr. Byrnes admitted that amendments to effect crossover were part of what was to be subsequently adopted by the delegated officer, if necessary or appropriate. Byrnes Depo (92) at 91-92 and 99. He conceded the neither the Senior Vice-President, nor he as the delegate of the Senior Vice-President, took further action until October 16, 2000. Byrnes Depo (92) at 91-92.

45. Don Harrington was the Senior Vice-President who presented the resolutions to the Board and was delegated the authority to adopt amendments. He testified that the “greater of” payment provision is not in the Board’s resolutions. Harrington Depo (95) at 207-8. He thought wearaway or crossover could be consistent with the intent of the design presented to the Board, but considered it to be part of the rules that he or Mr. Byrnes were to subsequently adopt as the Board’s delegate. Harrington Depo (95) at 208-9.

46. Interrogatories asked AT&T and the AT&T Pension Plan to identify the section or page of the Plan document or any Plan amendment that contained the transition rule described on page 2 of an August 16, 1999 brief that AT&T submitted to Judge Politan. This brief stated that “participants’ pension benefit amounts are calculated as the highest amount derived from two possible formulas - (1) the pre-Plan Amendment formula enhanced by the Special Update, calculated

as of December 31, 1996; or (2) the Cash Balance formula calculated as of the actual date the participant retires." See Ex. 17, Tab A (Int. 12 to AT&T). AT&T's brief cited pages 5-7 of the SPD as support for this rule, but did not identify a section or page of the Plan document or any Plan amendment that contained such a rule.

47. In its Answer, AT&T suggested that this wearaway or crossover rule follows "by necessary implication" from the "protected benefit" language in the Board's resolution. Ex. 17, Tab A (Answers to Int No. 20 addressed to AT&T Plan and Interrogatory Nos. 12 and 13 addressed to AT&T). This is, however, boilerplate that is contained in practically every Plan document, whether or not a plan has a wearaway. See, e.g., Section 10.2 of the previous Plan document, Ex. 6. A wearaway could not therefore follow from it by "necessary implication." The resolution on "protected benefits" does not, moreover, include the Special Update. It refers to benefits as of July 31, 1997, whereas the Special Update went into effect on August 1, 1997. It is illogical to contend that this resolution implies a wear-away of the Special Update when it does not even include it.

48. At his deposition, Lawrence Sher, AT&T's actuarial expert. suggested that an intention to have crossover could be "implied" from the Board's resolution on establishing an opening account balances. Sher Depo (102) at 182-84. But opening account balances do not necessitate wearaways or crossovers. For instance, the cash balance conversion for AT&T's occupational (union) workers had opening account balances but no wearaways. Gulotta Depo (93) at 197-99. AT&T's actuarial expert has conducted surveys of cash balance conversions which find that many conversions do not have wearaways, including ones with opening account balances. Ex. 19, Tab A (PwC/Unifi survey) at 35169-20 and Ex. 19, Tab B (Mellon survey) at 5 and 8-11.

49. As indicated above, AT&T's Board of Directors did not know what "crossover" was.

McHenry Depo (98) at 48 and 53, Wyman Depo (105) at 54-57. The presentation to the Board also failed to indicate that part of the value of participants' previously-earned benefits would be left out of the cash balance accounts, thereby setting up a wearaway. See Ex. 12. In a Supplemental Answer to Interrogatories, AT&T admitted: "There are no documents which relate to the AT&T Board's intention with respect to the issue of crossover." Ex. 17, Tab C (Int. No. 16).

50. There is no evidence that had AT&T's Board been given all the material information, it would have approved "crossovers" or "wearaways" of up to 13 years in which older employees do not earn any additional retirement benefits, while younger employees earn benefits "immediately."

51. Rather than authorizing implied amendments, the Board delegated authority to the Senior Vice-President to adopt further "necessary or appropriate" amendments "consistent with the intent of the cash balance design presented to the Board." Ex. 13.

52. The Plan's practice during the period beginning January 1, 1998 did not conform with the "greater of" provision ultimately contained in Section 4.06(a) of the October 16, 2000 Plan document, but was still more adverse for employees. The payment provisions in the Business Requirements were based on an "either/or" choice in which participants receive payment "irrespective of [the] greatest benefit." Ex. 20 at 26-27. The Business Requirements thus follow a provision that is not in the Board's April 1997 resolutions or the October 16, 2000 Plan document.

53. Although the October 16, 2000 Plan document was made retroactively effective to January 1, 1998, AT&T did not go back to change its practice to conform with the rule stated in Section 4.06(a). Nor does it comply with the "greater of" rule prospectively. Instead, it continues to follow the unadopted Business Rule under which participants receive a payment "irrespective of [the] greatest benefit."

54. As described in ¶¶ 211-12, special, more favorable benefit terms were offered to the AT&T/ASA employees who had designed the cash balance conversion under a June 1998 agreement. Those terms were not contained in the Board's April 1997 resolutions or in the October 16, 2000 Plan document. In fact they are not contained in any Plan amendment. The inconsistent treatment of the AT&T/ASA employees is further evidence that the Plan amendments that were adopted on October 16, 2000 and made retroactively effective to January 1, 1998 have not been consistently applied to all participants.

(2) The rule that the residual annuity under the cash payment and joint & 100% survivor annuity are "irrespective of [the] greatest benefit"

55. The rules in Section 4.06(b)(ii) of the October 16, 2000 amendments were also not in the Board's April resolutions or any earlier amendments. Section 4.06(b)(ii)(D) provides that the residual annuity under the cash payment option will always be based on the cash balance annuity even if the special update annuity is the greatest. Likewise, Section 4.06(b)(ii)(C) provides that the joint and 100% survivor annuity option is always based on the cash balance annuity even if the special update annuity is the greatest. Ex. 5. In sum, Section 4.06(b) again follows the Business Requirements in basing the benefit under the cash payment and joint & 100% annuity options on the participant's cash balance annuity, "irrespective of [whether this is the participant's] greatest benefit." Ex. 20 at 26-27.

56. By contrast, previous drafts of the Plan document provided that the residual annuity under the cash payment option and the joint and 100% survivor annuity were both to be based on the highest annuity available to the participant. Exs. 21 and 22 at Section 4.06(b)(ii)(C) and (D).

57. Mr. Harrington, who presented the cash balance proposal to the Board, testified that he believed that the residual annuity under the cash payment option had to be based on the Special

Update annuity if this was higher than the cash balance annuity and he "didn't know how they [AT&T] could do otherwise." Harrington Depo (95) at 119-22 and 213-14. Mr. Harrington thought this issue, too, "would be a degree of detail that would get beyond the board resolution." Harrington Depo (95) at 214.

58. There is no evidence in the record that had AT&T's Board of Directors been given all the material facts, it would have approved of offering benefit options in which employees might pick a cash payment or annuity that is not based on their highest benefit.

59. While Mr. Harrington "didn't know how [AT&T] could do otherwise," Harrington Depo (95) at 122, internal discussions continued internally about the rules on benefit options through at least the latter part of 1997. A September 1997 document recounts how the "actual provision was not clear to us." Stratman Rpt Ex. 13.

60. These discussions took place long after the April 1997 Board meeting that AT&T contends in this litigation resolved "all the necessary" details. See Ex.17 (Ans. to Int. No. 9: cash balance design was "fully adopted by the Board on April 16, 1997"; resolutions contained "all of the necessary amendments").

61. The internal communications addressed whether AT&T could "legally" offer "clearly less valuable" options to participants. Stratman Rpt Ex. 12 at 4861. An October 9, 1997 e-mail states: "In prior e-mails we confirmed that the Joint and 100% Survivor Annuity could be offered even though it was not actuarial equivalent to other immediate benefits available (e.g., the Special Update . . .)." Stratman Rpt Ex. 12 at 654.

62. Kal Basu, who was with Alan Sefcik one of the two "main players" on the cash balance design, Fromme Depo (107) at 11, indicated in a September 18, 1997 e-mail that, like Mr.

Harrington, he originally thought that an employee selecting the cash payment option would be entitled to a residual annuity based on their Special Update. His "original estimate was based on . . . the assumption that employees selecting a lump sum pay out were entitled to a pro rata portion of the special update based on the proportion of the cash balance amount remaining after the cash [out]." He stated that "Originally we took the more conservative position since the actual provision was not clear to us." Stratman Rpt Ex. 13. Mr. Basu upped AT&T's cost savings by over $400 million after it became clear to him that his "more conservative" position would be rejected: "The current assumption reflects the plan provision under which cash outs result in loss of entitlement to any special update."

63. The draft Plan document dated 9/2/1999 did <u>not</u> contain the adverse rules on benefit options that are set out in the October 16, 2000 Plan document. Ex. 21. A draft Plan document dated 7/15/1999 also did not contain those rules. Ex. 22. Instead, both drafts contained the rules that Messrs. Harrington and Basu "originally" thought would apply: Under both the cash payment option and the joint and 100% survivor's options, the annuities were to be based on the highest annuity computed under Section 4.06(a). Exs. 21 and 22 at Sections 4.06(b)(ii)(C) and (D). Kenneth Morgan and Allyson Liedtke acknowledged that the residual annuities under the cash payment option and the joint and 100% annuities would have been based on the greater of the cash balance or Special Update annuities under the 9/2/1999 draft. Morgan Depo (90) at 135-41; Liedtke Depo (97) at 72-74.

IV. AT&T's Duty to Notify Participants that the Cash Balance Amendments Reduce the Rate of Future Benefit Accruals

A. Disclosures about reductions in the rate of future benefit accruals under cash balance plans

64. It is well-known that the cash balance conversions have often resulted in lower rates of

benefit accrual than in effect prior to the conversion. A survey conducted by Unifi, a division of Pricewaterhouse, in May 2000 found that 59% of cash balance conversions reduced future accruals by 20% or more. Ex. 24 at 22 and Ex. 19, Tab A (PwC/Unifi survey) at 35206.

65. In an article discussing Unifi's May 2000 survey, Mr. Sher laments that in "most" cash balance conversions, employees have <u>not</u> received "details about significant potential benefit reductions." Instead, they receive "either general information or only a hint of potential reductions." Ex. 24 at 24. A September 2000 report by the United States General Accounting Office on cash balance conversions found the same lack of disclosure. Ex. 26 at 35.

66. The leader of AT&T's communications team on the cash balance conversion, Michael Bullard, has been quoted as saying that companies should be honest and "say it" if the "business strategy is to save money." Ex. 25 ("Demystifying Cash Balance"). AT&T's actuarial expert, Mr. Sher, is also on record urging sponsors of cash balance plans to "explain to people who will see reductions what will happen and why you are doing it so they will understand." Ex. 25 ("Cash Balancing Act"). "To the extent that some employees will not get as much as under the old program, [explain] the extent to which the company is taking steps to mitigate the reduction." Ex. 25 ("Demystifying Cash Balance," quoting Lawrence Sher).

B. ___The reductions under AT&T's cash balance amendments

67. The actuarial expert for the Plaintiff class, Claude Poulin, is a Fellow in the Society of Actuaries and the former Senior Actuary of the United Auto Workers. Mr. Poulin has served as a consultant to the Internal Revenue Service, the Equal Employment Opportunity Commission, the American Association of Retired Persons, the Communications Workers of America and the IBEW. He was retained by the EEOC to analyze cash balance plans and was the actuarial expert for the

Plaintiff class in the *Cooper v. IBM* case discussed in the summary judgment memorandum. Poulin Rpt ¶ 2 and Poulin Rpt Ex. B.

68. While AT&T's Plan document defines the "accrued benefit" in terms of the annuity, AT&T does not express the plan's benefits in that form, but expresses them in the form of pay and interest credits. As a result, Mr. Poulin had to convert the plan's benefits to annuity form to perform the statutory comparison of rates of benefit accruals.

69. Consistent with Treasury Department guidelines, Mr. Poulin converted the plan's pay and interest credits to annuity form. To determine the annual benefit accruals under AT&T's cash balance formula, Mr. Poulin projected interest on the pay credits allocated for a year to the participant's normal retirement age (age 65) using the interest credits specified under the terms of the plan. He converted the accumulated amount to an annual accrued benefit at age 65 by dividing by 114.96–the factor set forth in the Plan. Mr. Poulin then calculated the benefit accrual rate by dividing this amount by the compensation earned in that year.

70. Mr. Poulin's report revealed that for all AT&T employees earning less than the Social Security wage base who are over age 23, the amended cash balance plan offers a rate of benefit accrual that is significantly <u>less</u> than the 1.6% rate under the prior pay base formulas. Poulin Rpt ¶ 16. Ex. D to Mr. Poulin's report compares the rates of benefit accrual at each age after the Plan was converted to a cash balance plan with the benefit accrual rate in effect before the conversion. The reductions are significant at all ages, and even more substantial at the older ages. Poulin Rpt ¶ 16.

71. For participants from 21 to 55, the average rate of accrual after the cash balance conversion was between 1.35% and 1.4% compared to the 1.6% under the prior pay base formulas. As a percentage, this amounted to a 15% reduction in the rate of future accruals. Plan participants

between the ages of 55 and 65 experience a 20-35% reduction in their benefit accrual rates. The benefit accrual rate of 1.04% at age 65 represents a 35% reduction compared to the 1.6% benefit accrual rate under the previous version of the plan. Poulin Rpt. ¶ 17. Mr. Poulin graphed these reductions in his Ex. E.

72. The accrual rates for employees earning in excess of the Social Security Wage Base are somewhat higher because of the double pay credit that applies to earnings above the Social Security Wage Base under AT&T's plan design. Mr. Poulin's analysis shows that participants whose earnings are just above the Social Security Wage base still suffer a reduction in their rates of benefit accrual. Poulin Rpt at ¶¶ 18 and 20. The Excel spreadsheets that AT&T prepared for employees earning $75,000 demonstrate the same point: Employees earning $75,000 have lower accrual rates than previously. Poulin Rpt. Ex. F. Employees earning $160,000 generally have higher rates, except at the oldest ages. Id.

73. Mr. Poulin's findings that the new rates of benefit accrual are significantly lower under the AT&T Cash Balance Pension Plan were corroborated by Excel spreadsheets and graphs that AT&T prepared, which are attached under Poulin Ex. F. AT&T's Excel spreadsheets show "accrual rates" that are indistinguishable from Mr. Poulin's calculations. In particular, they show lower rates for all employee groups, with the exception of highly-paid employees (those making $160,000 or more).

74. AT&T also prepared graphs that show accrual rates below 1.6% of pay at all ages, too, with more of a decline after age 55. Poulin Rpt. Ex. F. Under corporate security restrictions, AT&T kept the Excel spreadsheets and the graphs "Confidential" and has continued to designate them as "Confidential" in this litigation.

75. In addition to the Excel spreadsheets and graphs, AT&T prepared percentage comparisons and bar charts on income replacement rates at 62 for employees who were ages 27 and 47 at the transition. Ex. 80 at 12768 and 12770. This information was presented at a high-level executive meeting in July 1996. The percentage comparisons and charts show significant benefit reductions under cash balance compared to the current plan--except for the "E Band" (executive-level) employees. The replacement percentages ranged from 30.8% to 38.7% for employees who were age 27 at the conversion, compared with 44.9% under the current plan. For employees who were age 47 at the conversion, the replacement percentages ranged from 37.1% to 41.5% compared with 44.9% under the current plan. Ex. 80 at 12678. AT&T concluded that the "income replacement ratio [is] expected to be less than under current plan." Id. at 12762.

76. Bar charts showing reduced levels of benefits were presented to the Board in April 1997. Ex. 12 at 34271. Don Harrington, the Senior Vice President who made the presentation to the Board, said he knew the age 62 income replacement targets were lower for employees in the A and C pay bands. Harrington Depo (95) at 199-201 and 204-5. Thomas Wyman, the CEBC's Chair, testified that he also knew the cash balance plan was a "lesser plan" "not quite as generous." Wyman Depo (105) at 21-22 and 29.

77. Michael Gulotta, the Enrolled Actuary for the ATTMPP, acknowledged that the "rate of benefit accrual" under the cash balance is "lower" than under the prior plan. Gulotta Depo (93) at 161-62.

78. A February 2, 1994 memorandum prepared by an in-house AT&T lawyer warned that conversion to a cash balance formula "where account contribution percentages stopped increasing beyond a certain age" could create problems because the rates of accrual will be "smaller" for an

older employee. Ex. 77. Mr. Poulin's Report shows that AT&T's "account contribution percentages stopped increasing" at age 55 and that this produces still lower rates of accrual between 55 and 65. Poulin Rpt. ¶¶14 and 17.

79. Under the prior pay-base formulas, AT&T's benefit accruals were not subject to any offset or contingency. If a participant earned $60,000 in 1996, an additional annuity of 1.6% of that pay (or $80 per month) became unconditionally due and payable. Poulin Rpt ¶ 30 and Ex. 6 (Section 4.2(a) and (b)). After the cash balance formula was introduced, future annual rates of accrual were, however, not only reduced by at least 15-35%, but they were also saddled with a new contingency. Poulin Rpt ¶ 30.

80. AT&T's actuarial expert has called the bottom part of the new payment rule a "frozen minimum benefit" provision. Sher Depo (102) at 201-4. An AT&T/ASA actuary describes the plan's formula in the same manner: "Since the Special Update is a frozen minimum and for the first few years exceeds the cash balance annuity, there is no increase in the benefits attributable to service for those years." Ex. 67 at 11412. AT&T's actuarial and financial reports also refer to the new payment rule as a "minimum pension benefit" provision. Ex. 24 at 26375 and 26399.

81. AT&T's frozen minimum pension provision affects the rate of future accruals because it excuses AT&T from paying the participant's annual cash balance accruals if the frozen Special Update exceeds the cash balance annuity and the participant elects to receive his or previously-earned benefits at early retirement. Because many participants receive "no further accruals," Ex. 89 at 33, the new frozen minimum provision obviously reduces the rate of future benefit accrual.

C. AT&T's notice to plan participants

82. AT&T does not contend that it gave notice of reductions by distributing the actual "Cash

Balance amendments" to participants 15 days in advance of their January 1, 1998 effectiveness. No cash balance amendments were adopted until October 16, 2000 and the Board's April 1997 resolutions were marked as "Confidential" and thus not made available to participants.

83. AT&T has, however, consistently taken the position that it gave Section 204(h) notice to the participants.

84. In a March 12, 2001 response to a representative of an employee, Michael Brown, who was listed as the AT&T Pension Plan Administrator, stated that AT&T gave Section 204(h) notice. He enclosed "copies of information that was provided to participants in the AT&TMPP beginning in April 1997, detailing the upcoming changes to the AT&TMPP" and stated, "We believe this constitutes notice in accordance with Section 204(h)." Ex. 28 at 33181.

85. A May 3, 2001 letter from Raymond Thomas at ASA, also states: "With respect to Section 204(h) of ERISA, we concur with Mr. Michael Brown's letter dated March 12, 2001 to Gary Mevorah, which stated that the various employee communications to Mr. Winters in 1997 constituted appropriate notice of the relevant plan amendments." Ex. 29.

86. In a privilege log presented to Magistrate Judge Hedges on August 30, 2001, AT&T identified two documents as containing legal advice or comments relating to its "Section 204(h) notice." Ex. 30. On October 3, 2001, Magistrate Judge Hedges ordered AT&T to produce both of those documents. The documents that were produced were drafts of AT&T's April 1997 letter and fact sheet. Ex. 31 and compare Stratman Rpt Ex. 1.

87. At his deposition, Kenneth Morgan, the lawyer who advised AT&T on Section 204(h) notice, testified that Section 204(h) notice was required and given. Morgan Depo (90) at 58-60, 115-6, 215-18. Messrs. Byrnes, Gulotta, Harrington, and Sefcik also testified that AT&T provided 204(h)

notice. Byrnes Depo (92) at 134-37; Gulotta Depo (93) at 28 and 162-64; and Sefcik Depo (91) at 76-77.

88. Discovery produced several additional documents showing that AT&T thought that Section 204(h) notice was both required and given. Ex. 32.

89. Although Section 204(h) notice is a fiduciary responsibility, AT&T blocked plaintiffs from obtaining further information about what AT&T was told by attorneys about whether 204(h) notice was required. Alan Sefcik, the Rule 30(b)(6) designee on rates of benefit accrual under 204(h) (see Sefcik Depo (91) at 204-5), was instructed not to answer those questions. Sefcik Depo (91) at 76-78.

90. The issue that was discussed internally was not whether Section 204(h) notice was required, but the contents of the notice: AT&T was concerned that the "statutory letters are formal and forbidding--they make people wary"; "[i]ssuing the statutory letter with [the] announcement letter would undercut the "sell" components of the announcement letter" about cash balance. Ex. 32 at 18407.

91. Mr. Morgan took the position that a statement that benefits were temporarily frozen would be sufficient. Morgan Depo (90) at 59-61, 116, 212-14, 217-21. Following his advice, internal memos stated: "No formal notice required, statement that benefits stop accruing as of XX date ok." Ex. 32 at 17578. "Per K. Morgan this will allow us to comply w/Act" Ex. 32 at 3062.

92. Consistent with this advice, the time line in the April 28^{th} fact sheet only disclosed that on July 31, 1997 "Current Accruals Cease." The next entry shows an August 1, 1997 "Effective Date" for the Special Update: "The special update goes into effect on this date." Stratman Rpt Ex.1.

93. Although Messrs. Morgan, Sefcik, and Gulotta all acknowledged that there was a "five-

month" freeze in accruals between August 1, 1997 and January 1, 1998, Morgan Depo (90) at 59-61, 116, and 217; Sefcik Depo (91) at 76-78, Gulotta Depo (93) at 162-65, AT&T's April 28th fact sheet and other brochures never mention a "five-month" cessation or freeze in accruals. See Stratman Rpt. Exs. 1-3.

94. AT&T questioned a number of class members about the Key Dates calendar in the April 1997 fact sheet. They testified that it meant that the earlier pay base formula ceased on July 31, 1997 and the special update formula started the next day. Smit Depo (111) at 125; McFall Depo (114) at 40; O'Brien Depo (115) at 54; Banfield Depo (119) at 54-55. No one understood there was a "five month" freeze.

95. A brochure that AT&T distributed in mid-November of 1997 stated, for the first and only time, that benefits under the Special Update were "frozen." Stratman Rpt Ex. 3 at 5. This was not, however, 15 days in advance of the effective date, but nearly four months after the temporary five-month freeze had taken effect.

96. Beyond notice of the temporary cessation in accruals, Mr. Morgan thought that all the Section 204(h) notice was legally required to do was "summarize the amendment." Morgan Depo (90) at 61-62, 104-5, 159-60, and 217-21. Under this theory, AT&T did not need to understandably disclose the reductions in accrual rates. All it had to do was "summarize the amendment." Id.

97. Mr. Morgan alternatively suggested that the "series" of brochures distributed in 1997 summarized all of the information employees needed to "understand" if the cash balance formula was lower for them than what they had before. Morgan Depo (90) at 105-6, 116-17, 120, and 219-23. At the same time, Mr. Morgan maintained that he did not believe it was "true" that there were any reductions. Morgan Depo (90) at 215.

98. As far as summarizing the cash balance amendments, it is undisputed that the April 1997 fact sheet does not summarize the cash balance amendments. Instead, it specifically states that "It will take time for the Company to be able to provide further information about how [the changes] affect your pension" and it deferred that information until November. Stratman Rpt Ex. 1 (first page of "Fact Sheet"). A brochure distributed in August of 1997 summarized the Special Update, but not the cash balance amendments. Stratman Rpt Ex 2.

99. The named Plaintiffs and other members of the class testified that it appeared to them from the April 1997 letter and fact sheet and the August brochure that the new pension was an improvement or a positive change. DiCerbo Depo (117) at 48, 51, 57; O'Brien Depo (115) at 55. Mr. Noerr testified, "How would we know that we were losing benefit rather than gaining benefit?" AT&T was "not telling me that there was a disadvantage." Noerr Depo (116) at 39 and 74.

100. AT&T's November 1997 brochure summarized the cash balance amendment in general terms, but it did not tell employees about any reductions in future accruals in a manner "calculated to be understood by the average plan participant." Compare Stratman Rpt Ex 3 and 26 C.F.R. 1.411(d)-6, Q&A 10.

101. Reviewing AT&T's disclosures, the Plaintiffs' communications expert found that AT&T did not give notice to employees of:

(a) The future reductions in the rate of accruals under cash balance of 15-20% or more compared to the 1.6% rate under the prior pay based formulas; or

(b) The new contingency that AT&T had attached to the payment of any of the future cash balance pay and interest credits.

Stratman Rpt at 2.

102. Professor Stratman found no understandable disclosures to employees that the cash

balance formula produced lower benefits than what they had before. Furthermore, he found that employees were not given the tools to compute their cash balance benefits in annuity form and compare them with the prior benefit formula. Stratman Rpt at 17.

103. Michael Gulotta, the Enrolled Actuary for the Plan, agreed that the purported 204(h) notice does not "clearly tell me that the cash balance accruals are less." Gulotta Depo (93) at 169-71.

104. Managers selected for six focus groups in September 1997 thought that AT&T's cash balance brochure was "spin" and an effort to "sell" cash balance and that AT&T "was not being straightforward in its explanation of the reasons for the change to Cash Balance." "Many felt that if AT&T needs to "reduce benefits" through the cash balance plan to remain competitive in the telecommunications industry, the company should "come right out and say it." Stratman Rpt Ex 8 at 14667; see also id. at 14669 and 14672 on the "content" issues. Telephone callers in November 1997 conveyed the same message: "They feel AT&T should step up and admit the changes negatively affect them." Ex. 79 at 16479.

105. Focus groups conducted in both June 1997 and September 1997 (a total of 14 different focus groups were conducted in these two periods) consistently asked AT&T to "provide a comparison of the old vs. new." Bosley Rpt Ex 8 at 6259 and 6272 and Stratman Rpt Ex 8 at 14667. "Most managers . . . suggested that the traditional pension plan should be used in comparison to the Cash Balance." Stratman Rpt Ex 8 at 14669. HR Leaders asked the same question. Ex. 84 at 16232 ("How do the numbers in the old plan compare to the new plan?").

106. AT&T made an intentional decision to withhold comparative information. George Fromme, who was AT&T's Director of Benefits Planning, testified that the issue that "everyone" involved in the cash balance design "was concerned about is that they [employees] would make a

comparison of the cash balance assuming the old plan would get updates." Fromme Depo (107) in Peterson at 103.

107. Ken Willetts was the chief speaker for AYCO, a company that conducted cash balance seminars on AT&T's behalf. He testified that the AYCO seminar speakers were instructed <u>not</u> to draw comparisons between Special Update and Cash Balance and did not have the necessary information to draw such comparisons. Willetts Depo (110) at 176-77. A memorandum from Mr. Willetts dated June 6, 1997 states that "on an on going basis Ayco, company wide, will not do any comparisons of "what might have been"." Ex. 69.

108. In a videotaped seminar for HR Leaders and AYCO speakers, Mr. Willetts discussed how to avoid telling employees outright that the cash balance formula reduces benefits. HR leaders and AYCO speakers were instructed not "to lie" but to refuse to compare the new benefits with the old ("I won't do that. Okay?") and to qualify any responses as based on "certain assumptions." Magistrate Judge Hedges issued an Order on June 4, 2004 specifically directing that AT&T produce this videotape.

109. On the tape, Mr. Willetts states that "quite honestly, if some people run that [calculation], their benefit could be higher under the old plan than this plan. I'm not going to say no, it isn't because the fact is it could be if you make certain assumptions." Ex. 35 at 5-7. He continued: It "is true that it could be better under the old plan than it is under this plan, but that's based upon assumptions, and if you're going to make those assumptions, I think it's also as likely or as realistic that you might have to make some [other] assumptions that they would change the interest crediting rate on the account balance to be something more than four percent." Ex. 35 at 8.

110. Mr. Willetts explained, "I'm really saying this and going into very big detail because I'm

being videotaped today. We're using this as a training tool for other AYCO speakers. I want them to know how to deal with this." Ex. 35 at 8-9.

111. Instead of disclosing reductions, AT&T's explanations to participants suggested that cash balance benefits were at least comparable. In the mid-November cash balance brochure, two graphs illustrate how the cash balance plan accumulates "benefit value" more smoothly than a traditional pension formula. The graphs indicate that both pensions end up at the same place and show the cash balance providing more benefit value at practically every earlier age. Stratman Rpt at 11 and Stratman Rpt Ex. 3 at 3. An earlier version of the same graph more accurately showed the cash balance benefit winding up significantly below the traditional formula. See Ex. 34 at 35401.

112. Even after this litigation was brought, AT&T continued to resist disclosing to employees that the cash balance conversion reduced benefits. On February 10, 2000, AT&T's executive vice-president for human resources circulated a message to all AT&T managers in response to letters from employees. The message states that "generally, cash balance pays greater benefits prior to meeting the minimum age and service requirements and after about age 60." Ex. 36 at 34223 (emph. added).

113. AT&T's new contingency on the payment of future cash balance accruals also reduced those accruals. This contingency has affected all of the named plaintiffs and every class member who was deposed. For example, when they retired, named Plaintiffs Phil Engers and Donald Noerr received nothing more for their years of work after 1997 because of the contingency that AT&T placed on payment of their future cash balance accruals. Poulin Rpt. Ex. G. Warren McFall received

less than one-year's accruals for four years of work. Ex. 83.[2] In Bonny Berger's words, her retirement benefits were "destroyed" by the 13-year wearaway period during which she would be earning nothing more in benefits. Berger Depo (120) at 76 and 95.

114. In Interrogatory No. 20 addressed to AT&T, AT&T was asked whether it ever disclosed to employees that "actual benefit accruals under the cash balance design will not materialize until the crossover year is reached, which may not occur for a number of years." AT&T responded that this "was <u>not</u> disclosed to Plan participants because [it is] <u>not true</u>." Ex. 17, Tab A (Ans to Int. No. 20 to AT&T, emph. added).

115. In the Peterson v. AT&T litigation, Ken Willetts and Mike Fazio, who presented cash balance seminars for AYCO, both testified that AT&T had not released information on the workings of Cash Balance or on crossover in the May to October time period of 1997. If a person asked whether he or she was better off under Special Update or Cash Balance, they were unable to answer based on communications that AT&T had released. Willetts Depo (110) at 61-64; Fazio Depo (108) at 32-34.

116. Professor Stratman indicated that a reference in the April 1997 fact sheet to employees being "better off" and receiving what "works best for you" does not indicate (except in hindsight) that employees will receive no additional benefits for 7 years, but suggests instead a grandfather provision under which benefits will be computed under both the old and the new formulas on an on-going basis. Stratman Rpt at 7-8. AT&T told employees on the first page of the communication that "these changes will benefit both you and the Company," Stratman Rpt Ex. 1 at 1, and the very next

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[2] Phil Engers retired in June 1999 at age 50 and 7 months; Warren McFall retired in November 2000 at age 62 and 4 months. Ex. 83. Don Noerr retired in February 2002 at age 59 and 10 months. Named Plaintiff Gerald Smit is still employed.

section of the fact sheet assures employees that "the starting value of your cash balance account next year will be based on your benefit under the special update," id. at 4, dispelling any notion that AT&T was setting the opening accounts below the value of the Special Update. AYCO's cash balance speakers, Messrs. Willetts and Fazio, pointed out that employees did not know anything about cash balance at this point, Fazio Depo (108) at 32-34; Willetts Depo (110) at 61-64, and would not have understood an indirect reference to "crossover"--a term which was only introduced in November. A telephone survey conducted for AT&T in June 1997 confirmed that the understanding of the employees who remembered the April 28th communication was consistent with AT&T's message, i.e., the vast majority understood that the cash balance changes were designed to be beneficial for both them and the Company. Bosley Rpt Ex. 7 at 14548-14552.

117. Illustrating the common understanding of receiving the "better of" two benefits to which Professor Stratman refers, AT&T's chief spokesperson, Burke Stinson, told a Bureau of National Affairs reporter in December 1999 that: "AT&T employees within five years of retirement were given the choice to stay under the traditional defined benefit plan or to opt for the cash balance plan, noting that he [Stinson] chose to stay under the old plan." Ex. 38.

118. Since AT&T designed the conversion factors, it was well aware that the opening cash balance accounts were lower than the value of the Special Update. But employees did not know this and AT&T did not wish to disclose this. At an internal meeting in December 1996, "Alan [Sefcik] indicated he expects instances where 45% of the Transition benefit will be greater than the CBA annuity." Ex. 64. A communications meeting in September 1997 observes that "for 97%" SU "is the better benefit," but then asks: "Why would we want to tell people that the special update is higher than Cash Balance?" Stratman Rpt Ex. 6. Kenneth Morgan stated in October 1997 that the Special

Update annuity could be "perhaps as much as three times as large" as the Cash Balance annuity. Stratman Rpt Ex. 9. Mr. Morgan then "suggests we reconsider comparing special update and cash balance annuities" because the special update will be "significantly large[r] for the "vast majority of participants." Id.

119. At his deposition, Mr. Morgan maintained that there was "no need to disclose" the lower values of the opening accounts in a 204(h) notice or an SPD because there is "no requirement" that a cash balance conversion be based on the subsidized Special Update. Morgan Depo (90) at 178-80. In Mr. Morgan's view, because there was no IRS "requirement" that the opening balance be based on a subsidized benefit, there was also no need to disclose the opening accounts represented less than half of the value of the annuity. Morgan Depo (90) at 178-79.

120. In his review, Professor Stratman found that AT&T not only failed to disclose the lower values, but it affirmatively suggested the cash balance account represented the full value of the Special Update. The April 1997 fact sheet represents that "The starting value of your cash balance account next year will be based on your benefit under the special update." Stratman Rpt. Ex. 1 at 4. Professor Stratman cites statements to the same effect in the November cash balance brochure. Stratman Rpt at 11-12. Briefing materials prepared for the cash balance seminar speakers also state that the "Special Update benefit (undiscounted at age 55) is converted into the Opening Cash Balance." Ex. 33 at 35348 and 35349. The cash balance seminar scripts likewise show that participants were told that the opening cash balance account was based on the "undiscounted (age 55) Special Update." Ex. 34 at 35404.

121. After reviewing AT&T's disclosures, AT&T's communications expert, Dr. Bosley, testified that she had <u>not</u> understood that the starting point under cash balance was below the Special

Update. Bosley Depo (100) at 203-7. Mark Johnson, a former American Airlines manager who AT&T presented as an expert on benefits administration, stated in both his report and his deposition testimony that after he reviewed AT&T's brochures, he understood that the "early retirement subsidy was built into the Cash Balance Accounts." Johnson Rpt at 16 and Johnson Depo (101) at 194-96.

122. AT&T's November 1997 brochure offered a technical definition of "crossover" near the back of the booklet (Stratman Rpt Ex. 3 at 23), but the brochure did not connect this concept up with the descriptions of pay and interest credits that could be lost--potentially for up to 13 years. The brochure instead assures participants that "You'll receive pay credits and interest credits each year you work." Stratman Rpt. Ex. 3 at 8.

123. AT&T's communications team was focused on "selling" cash balance, even if it meant minimizing or not disclosing the "bad parts." Ex. 73 at 17786 and 27243. Minutes dated April 15, 1997 describe how there will be a "bigger sell on cash balance than ever before." Ex. 73 at 17786. After asking "Do we want to explain the crossover or sell Cash Balance?" AT&T's communications team suggested as a self-described "compromise" that the November brochure should "only include a definition and refer them [the employees] to where they can find more information." Stratman Rpt Ex. 6 at 27246. AT&T followed through with the first part of this suggestion. Employees were not referred "to where they can find more information." See Stratman Rpt Ex. 3 at 23.

124. Professor Stratman's report reviews how the definition of "crossover" near the end of the November 1997 brochure does not explain the concept in an understandable manner and does not connect it up with the descriptions of the pay and interest credits will not be payable at all until the "crossover" point is reached. Id. at 19. No disclosure were offered that "crossover" was deliberately designed by AT&T, and was not required by any law or anything inherent to a cash balance

conversion. The GAO found that "Plan sponsors determine whether to create wearaway at conversion." Ex. 26 at 29.

D. AT&T's defenses

125. In depositions, two AT&T witnesses tried to distinguish AT&T's own Excel spreadsheets and graphs as limited to "accrual rates" for purposes of ERISA 204(b)(1)(B) and 204(b)(1)(H), but not Section 204(h) rates of benefit accrual. Sefcik Depo (91) at 72-75; Morgan Depo (90) at 215-16. Both deponents admitted, however, that AT&T never performed any other calculations of accrual rates for purposes of Section 204(h). Morgan Depo (90) at 58 and 218; Sefcik Depo (91) at 74-75 and 199-207. Moreover, the suggested differentiation does not appear in any contemporaneous documents. AT&T produced nothing in discovery showing a different calculation or definition of accrual rates for purposes of Section 204(h).

126. AT&T's actuarial expert agreed with Mr. Poulin that the Plan's prior rate of benefit accrual was 1.6% but declined to compute "future benefit accruals" or "rates of future benefit accruals" under cash balance for comparison with the prior formula. He disagreed with or questioned the position of the Treasury Department that for purposes of Section 204(h) the rate of future benefit accrual is determined annually. Sher Depo (102) at 81-82. Setting aside the labeling, however, Mr. Sher's spreadsheets calculate the same future benefits from year-to-year and the same annual accrual rates as Mr. Poulin. Poulin Deposition Exhibit 10 revises Mr. Sher's Ex. C-1 to display the future benefits accruals and the future rates of accrual on an annual basis and finds the same results as Mr. Poulin obtained. Compare Sher Rpt. Ex. C-1 with Ex. 54.

127. In an October 1999 article, AT&T's actuarial expert was willing to admit that cash balance plans tend to produce lower future accruals. He wrote that the change to a cash balance plan

"tends to result in a slower growth of future benefit accruals (or even no growth for a while) for some mid-career employees" and "in many cases certain employees will accrue lower benefits than they would have under the prior plan." Ex. 25 at 20-21.

128. At his deposition, AT&T's actuarial expert also produced spreadsheets, which he had prepared but did not include with his report, which showed that some participants would experience reductions in benefit accruals, even if he was allowed to move the significant improvements from the 1997 Special Update over to the other side of the equation and treat them as part of the future accruals under the January 1, 1998 cash balance amendments. Ex. 39 and Sher Depo (102) at 74-75 and 227-33. Mr. Sher was careful to say in the final analysis that he was <u>not</u> expressing an opinion on whether Section 204(h) notice was required. Sher Depo (102) at 73-4.

129. AT&T's actuarial expert suggested that in some cases the reductions in future accruals could be eliminated if the 1997 Special Update was considered to be an "advance" against reductions in future accruals after 1998. Sher Rpt (Ex. 3) at 11 n. 14 and 26 n.33. But AT&T told the employees that the 1997 movement in the pay window was an "update," like seven previous ones, designed to bring their benefits in line with their more recent salaries. Stratman Rpt Ex. 2 at 6 (it is the "last increase of its kind"). The Board was also told that this was an "appropriate" time to update the plan because the company was "presently behind" and the employees were "anticipating change." Ex. 12 at 34262. The Plan's Enrolled Actuary agreed that the Special Update was not described as "accelerated accruals." Gulotta Depo (93) at 215-16. As Judge Bassler found, "The Special Update Benefit . . . reflect[s] <u>all work performed before 1997</u>." Both AT&T's Plan document and its SPD describe the Special Update as one of the plan's "<u>prior</u> pay base averaging period formulas." Stratman Rpt Ex. 4 at 5 and Ex. 5 at Sections 4.05 and 4.06.

130. The common law establishes that a payment is considered to be an "advance" only when the person receiving it is informed and knows that it is going to be deducted from future obligations. Without notice, there is nothing to differentiate a $10,000 end-of-the-year increase in an employee's salary from a $10,000 "advance" on next year's salary. See, e.g., *Powder v. Burkhardt*, 97 U.S. 110, 117 (1877) ("To advance is to "supply beforehand," "to loan before the work is done or the goods made." This is the popular understanding of the language, as well as the accurate definition"). *Black's Law Dictionary* (7th ed.) defines an "advance" as "the furnishing of money or goods before any consideration is received in return." An "advance payment" is "a payment made in anticipation of a contingent or fixed future liability or obligation." Id. *Roberts' Dictionary of Industrial Relations* (4th ed.) defines an "advance" on wages as a "payment of earnings prior to the regular pay day." "Some firms may provide [an] advance for a period of weeks or months, to be repaid when earnings or commissions are received." Id.

E. Understandable notice of benefit reductions is not technically difficult

131. Everyone agrees that it is not difficult to give employees honest information about benefit reductions. AT&T's communications expert, Professor Bosley, agrees that disclosures about benefit cuts are relatively easy to give. Bosley Depo (100) at 239-41. The resistance stems from the employer's discomfort in telling employees about reductions, rather than technical difficulties in communicating the information. Bosley Depo (100) at 240-41.

132. Professor Bosley's report does not address whether AT&T disclosed the benefit reductions under cash balance in an understandable manner. See Bosley Rpt at 44-50. The closest AT&T's communications expert came to identifying any disclosure of benefit cuts was to suggest that the April 1997 letter hints at a reduction when it refers to keeping AT&T competitive with other

companies. Bosley Rpt at 45. A July 1997 survey commissioned by AT&T shows, however, that most of the managers who read the April 1997 package thought the changes were positive for both themselves and AT&T. Bosley Rpt. Ex. 7 at 14551-52.

133. New regulations on Section 204(h) illustrate how reductions can be disclosed in narrative, percentage, and numerical terms. For example, a narrative disclosure can describe the relevant benefit formula before and after the amendment and where the approximate magnitude of the reduction is not reasonably apparent from the narrative offer sufficient information for participants to determine the approximate magnitude of the expected reduction. 68 F.R. 17277, codified in 26 C.F.R. 54.4980F-1, Q&A 11.

134. The GAO's report on the implications of cash balance conversions contains an example where employees are advised that "the change we are making results in a reduction in the rate of future pension accruals." Ex. 26 at 36. A Section 204(h) notice that Citigroup issued in 1999 likewise tells employees that "Citigroup has adopted an amendment that may reduce accruals for certain employees." Ex. 40.

V. AT&T's Use of Bookkeeping Entries in Place of Payable Benefit Accruals for Purposes of the 133% Accrual Test

135. AT&T maintains that the Management Pension Plan complies with the 133 1/3% method for benefit accruals (which is prescribed by ERISA § 204(b)(1)(B), 29 U.S.C. 1054(b)(1)(B)). AT&T Applications for Determination to the Internal Revenue Service in both 1995 and 2002 represent under oath that the Plan "satisfies" the 133 1/3% accrual rule. Ex. 41.

136. Under the AT&T benefit formula in effect before the cash balance conversion, each year's accrual was separate and unconditional as required for compliance with the 133 1/3% rule. For example, if a participant earned $60,000 in 1996, an additional annuity of $80 per month ($60,000 x

1.6% ÷ 12) was unconditionally due and payable. Payment of the additional annual accrual of 1.6% of pay was not contingent on giving up any part of the value of previously-earned benefits. Poulin Rpt. ¶ 30.

137. As amended on October 16, 2000, however, the AT&T Plan document contains a benefit payment provision that makes participants' receipt of the future cash balance accruals contingent. The amended Plan stipulates that participants can receive the benefits they earned under the cash balance formula beginning in 1998 only if they forego the unreduced early retirement benefits, payable from age 55, that were earned under the prior formula before 1998. Ex. 5 at Section 4.06(a). ERISA Section 204(g) protects the latter benefits. The Plan document thus makes the statutory right to annual benefit accruals for plan years beginning in 1998 contingent on giving up part of the statutory right to benefits earned in the period before 1998.

138. Kenneth Morgan, the principal scrivener of the amended Plan document, testified that he sought to conform the Plan with IRS Notice 96-8. Morgan Depo (90) at 36-7. Notice 96-8 provides that "conditioning entitlement to benefits on the employee not taking a distribution violates the nonforfeitability requirements of section 411(a)" of the Code and section 203 of ERISA. Ex. 86 at *15. The amended Plan document which Mr. Morgan drafted provides that participants who take early distributions must choose between: (a) the right to the pay-base formula benefits earned up to 1997, which is statutorily protected under ERISA 204(g), with no additional accruals, or (b) cash balance benefit accruals for plan years after 1997, computed in accordance with ERISA's 133 1/3% rule. AT&T's amended plan provision thus attempts to discharge two different statutory obligations covering two distinct time periods by paying a benefit that complies with only one of those statutory obligations.

139. Mr. Poulin's Ex. G numerically illustrates the impact on Don Noerr, one of the four named Plaintiffs, from the contingent payment of future accruals. On January 1, 1998, Mr. Noerr was eligible for a pension benefit of $18,276 a year or $1,523 a month. When he retired over four years later this was still the only benefit that he actually received. Poulin Rpt Ex. G. The pay credits and interest credits for Mr. Noerr between 1998 and 2002 were no more than bookkeeping entries because they were not actually payable to Mr. Noerr.

140. The same contingency has made the annual accruals of other older, longer-service participants valueless. Named Plaintiff Phil Engers was nominally allocated pay and interest credits from 1997 through June 1999, but when he retired he received none of those benefits. Ex. 83.

141. The Plan's Enrolled Actuary, Michael Gulotta, acknowledged that there is "no further accrual" during a wearaway period. Gulotta Depo (93) at 103 and Ex. 89 at 33.

142. An AT&T document prepared in 2000 to respond to media questions also recognizes that "older employees will see no increase to their pension for several years." Ex. 36 at 34257. Mr. Morgan, AT&T's in house attorney, is more blunt: "I understood accruing no additional benefit no matter how you measure it, no matter what definition was a zero accrual rate." Morgan Depo (90) at 217.

143. According to a November 1, 1998 article in *Compensation and Benefits Review*, written by Hal Burlingame and Michael Gulotta, AT&T's Executive Vice-President for Human Resources and the Plan's Enrolled Actuary, the cash balance accruals are designed to "move ahead of the old plan" "beginning at about age 60." Ex. 42. A spreadsheet on crossover that Alan Sefcik prepared shows immediate increases in benefits for most employees who are age 62 and all who have reached age 63. Ex. 45

144. Under AT&T's design, older, longer-service AT&T employees accrue no additional benefits under the cash balance formula – until the value of their cash balance account, which is initially set back, finally exceeds the value of the pension benefit they had already accrued under the prior formula. Beginning at that point they earn additional benefits. Poulin Rpt ¶ 34.

145. Because the years of no accruals resulting from the wearaway contingency are ultimately followed by benefit accruals in a "later plan year" ("beginning at about age 60"), the rate of benefit accrual at that time is "infinitely greater" than the zero rate of accruals during the wearaway period. Poulin Rpt ¶ 34.

146. While older, longer service employees are subjected to a period with no accruals, "younger employees" and new hires are not. Instead, they "immediately" begin to earn retirement benefits computed in compliance with the 133% rule. Ex. 44 at 18298; Ex. 43 at 12509; Ex. 84 at 16236 ("The reason John crosses over immediately is because of his younger age."). New hires also begin to accrue benefits immediately because the condition on payment in Section 4.06(a) of the Plan document only applies to individuals who were plan participants before 1997. Ex. 5. Michael Gulotta, the Enrolled Actuary, testified that for younger employees, "there absolutely is an increase in benefits." Gulotta Depo (93) at 98. Spreadsheets on crossover prepared by Alan Sefcik show immediate increases in benefits for all employees <u>under</u> age 44. Ex. 45 (on 13989, the handwritten legend on the right reads: "# years it will take until CB = transition ben (conservative)"; empty cells indicate that the cash balance benefit is immediately greater than the transition benefit).

147. An older, longer service employee like Mr. Noerr receives a nominal benefit credit based on a percentage of his salary until he reaches age 60 or 62. At that point, he will again begin to receive benefit credits that are actually payable to him. Poulin Rpt. ¶ 34 and Poulin Rpt. Ex. G.

However, a younger employee or a new hire receives a benefit credit based on his or her salary that is "immediately" and unconditionally payable.

148. A February 2, 1994 legal memorandum prepared by an in-house AT&T lawyer warns that conversion to a cash balance formula could create problems complying with the backloading rules under ERISA § 204(b)(1). The memo finds that many cash balance conversions have played "fast and loose" with the backloading rules and been "much too quick to use superficial analogies." Ex. 77 at 4856 and 4860.

149. AT&T did not produce any subsequent legal advice concerning whether the contingent payment effected by Section 4.06(a) of its amended plan complies with the 133% rule. AT&T never analyzed the issue of whether each year's benefits had to be payable at the normal retirement age to comply with the 133% rule. See Sefcik Depo (91) at 100.

150. AT&T's actuarial expert represents that the IRS permits Plan sponsors to run the 133% test without regard to the effect of any minimum benefit formula on the plan's actual accruals. Sher Rpt at 27 and Sher Depo (102) at 159-68. Mr. Sher is "not prepared to say for sure" whether there are any restrictions on the length of wearaways. Sher Depo (103) (in Amara v. Cigna) at 253-55. Kal Basu, one of the two "main players" on the cash balance design, likewise suggests that "You have to look at each formula separately" without regard to whether one part of the formula negates payment of the accruals under the other part. Basu Depo (106) at 120.

151. IRS regulations, as in effect since 1977, provide that when benefits are computed under more than one plan formula, e.g. a minimum benefit formula and another formula, the benefits under such formulas are aggregated to determine whether the plan's accruals are in compliance:

> A defined benefit plan may provide that accrued benefits for participants are determined under more than one plan formula. In such as case, the accrued benefits under all such

> formulas must be aggregated in order to determine whether or not the accrued benefits under the plan for participants satisfy one of the alternative methods.

26 C.F.R. 1.411(b)-1(a).

152. The American Academy of Actuaries is aware of these regulations. It states "Currently, if employers give "greater of" they can run afoul of a strict reading of the accrual regulations." Ex. 47 at 7. At his deposition, AT&T's expert admitted that he helped the American Academy draft a September 14, 2000 letter complaining about how the IRS applies the aggregation regulation and asking that the regulation be revised. Sher Depo (102) at 162-67 and Ex. 48.

153. At an October 2003 meeting of the Conference of Consulting Actuaries, AT&T's actuarial expert asked officials from the IRS about the application of this regulation to plans with minimum benefit formulas. He was told that the aggregation rule in the regulations applies: "You look at the net benefit and when you have . . . a period of zero years and the other kicks in, it's an issue on a 133 and 1/3." Ex. 46 at 12.

VI. AT&T's 6% Per Year Reduction Factor For Immediate Commencement of Benefits

154. In both the Plan document and AT&T's disclosures, AT&T provides that participants can receive the undiscounted age 55 early retirement benefit before age 55 subject to a 6% per year reduction. Section 4.06(a)(ii)(A)(2) of the amended AT&T Plan document provides for a reduction for each month "by which the Participant's age at the Pension Commencement Date is less than fifty-five years" of "one half percent" for each such month (which works out to 6% per year). Ex. 5.

155. The SPD likewise states that there is a 6% a year "discount for pension commencement before age 55." The discount is based on the number of "months before age 55." Stratman Rpt. Ex. 4 at 9-10. The brochure entitled "Your Pension Improvements" distributed in August 1997 states that "if you begin receiving your payments before age 55, your monthly pension will be discounted for

payment over a longer period of time. . . If you start receiving payments early, your monthly check will be less than if you started at age 55." Stratman Rpt Ex. 2 at 8-9.

156. To a pension actuary, a 6% per year reduction for commencement before age 55 is on its face not an actuarial reduction because it operates on a linear basis, eliminating any benefit by age 38 and 4 months (6% x 16⅔ years = 100%). An actuarial reduction would, by contrast, be curvilinear with the reduction tapering down at earlier ages. The tapering is due to the fact that the changes of death are progressively less in each year before 55. See Poulin Rpt ¶ 38.

157. Mr. Poulin's expert report opines that while a 6% early retirement reduction is common for retirements between ages 60 and age 65, and to a lesser extent to retirements between ages 55 and 60, pension plans usually do not extend a 6% reduction below age 55, because it is considered to be an excessive reduction. The 6% reduction causes the participant to lose or forfeit part of the value of the benefit. Poulin Rpt. ¶¶ 38-43.

158. AT&T's actuarial expert admitted to the accuracy of Mr. Poulin's analysis indirectly, describing it as "appealing on the surface," Sher Rpt. at 32, and at the conclusion of his deposition describing it as a "quirk in the plan." Sher Depo (102) at 295.

159. Michael Gulotta, the Plan's Enrolled Actuary, and Donald Harrington, the Senior Vice-President for Compensation & Benefits, both agreed that a 6% reduction is not an actuarial equivalent when applied to commencements before age 50. Gulotta Depo (93) at 57-60; Harrington Depo (95) at 137-42 and 211-3. Mr. Harrington testified that he believed AT&T would have modified the 6% reduction factor if the IRS had brought the matter up. Id. However, AT&T did not apply for a determination letter from the IRS until 2002.

160. Mr. Poulin prepared Ex. J comparing the percentage of the age 55 benefit that is payable

at each retirement age from 38 to 55 under, respectively:

(a) Reduction factors of 6% per year,

(b) Reduction factors of 3% per year,

(c) Reduction factors based on the table in Section B.03 of the monthly benefit derived from Cash Balance Accounts payable before Normal Retirement Age [Ex. 5 at page 86], and

(d) Reduction factors based on GATT mortality and an interest rate of 5%.

161. Ex. J to Poulin's Report shows that the pension benefit payable at age 40 is reduced to 10% of the undiscounted age 55 benefit with a 6% per year reduction, while it remains at between 39% and 55% of the age 55 benefit under all three other sets of reduction factors. According to Mr. Poulin, while the percentages in Columns (4) and (5) vary slightly because they are based on different interest and mortality tables, both represent "reasonable actuarial reductions." The same cannot be said of a 6% per year reduction. Poulin Rpt ¶ 41.

162. Poulin's Ex. J also shows the average reduction factor by age band (38-40, 41-45, 46-50, and 51-55) under each set of factors. He shows that below age 50, the 6% reduction that AT&T applied is always substantially more than an actuarially-equivalent reduction. Poulin Rpt. ¶ 42.

163. In Bonny Berger's case, an actuarially-equivalent annuity at age 41 and 1 month would have been worth 2.6 times more than her annuity after AT&T's 6% reduction. Dollie Dobbins, another employee who separated at age 48 and 4 months with nearly 30 years of service incurred a discount that was 10% more than an actuarial equivalent. Poulin Rpt ¶ 42.

164. Instead of telling participants that the 6% per year reduction was excessive at early ages, AT&T assured them that it was not. A brochure entitled "Your Pension Plan Improvements," which was distributed to all participants in August 1997, represented that if a participant starts receiving

payments before age 55, the "overall value of your pension likely will remain the same. That's because with a discounted pension, you're stretching the same pension dollars over a longer span." A footnote states that "The value remains the same on average for all participants." A graphic of a dollar bill to the side is entitled "Effect of Early Payment" and shows the dollar being stretched over a longer period before age 55. Stratman Rpt. Ex. 2 at 8.

165. In Mr. Poulin's opinion, these were not accurate representations about "value" because a 6% per year reduction exceeds a reasonable actuarial reduction. Poulin Rpt ¶ 44. Internal meeting minutes indicated that the communications personnel who drafted the brochure had been inaccurately told that the reductions "for those less than 55 " were "actuarial reductions." Ex. 73 at 17793.

166. Brian Byrnes, AT&T's designated Rule 30(b)(6) witness on disclosures, acknowledged that the SPD and other brochures do not disclose "in so many words" that the 6% reductions may be actuarially excessive. He remembers no consideration of this issue. Byrnes Depo (92) at 131-32, 152, and 154-56.

167. AT&T and ASA were aware of the *Costantino v. TRW* and *Medeika v. SNET* cases. Ex. 49 at 33630 and Morgan Depo (90) at 182-88 (refusing to directly name the client on grounds of confidentiality). The defendant in the *Medeika* case was SNET, which was part of the former Bell System and another one of ASA's clients. Medeika was filed in June 1997. Production of the cash balance brochure was, in fact, "halted" in October 1997 specifically because of these cases. Id. But AT&T and ASA only used this as an occasion to change nomenclature: A reference to certain factors as "Annuity Conversion Factors" was changed to Simplified Calculation Factors or Monthly Payment Factors. Ex. 49 at 33631 and Morgan Depo (90) at 187-88. No actions were taken to conform with the TRW decision and no disclosures were offered to the employees who lose a

substantial part of the actuarial value of their benefits with early commencements.

168. The class list prepared by AT&T shows that since 1997, 19,454 participants have commenced benefits before age 55. Of those, 15,116 commenced their benefits before age 52 and 11,243 commenced benefits before age 50. Anderson Decl. ¶ 3. AT&T subjected the age 55 benefits of each of these participants to an actuarially excessive 6% per year reduction.

169. At her deposition, AT&T asked Ms. Dobbins what she wants to get out of this litigation. She testified that she hopes to get a discount rate that is not any "higher than it should be." She did not know that the 6% discount was excessive on an actuarial basis, but had "trusted" AT&T that "the numbers were properly calculated." Dobbins Depo (118) at 87-8.

VII. The SPD's Disclosures About Benefit Reductions

170. It is well-known that offering benefits in a cash balance form "masks a lot of the changes." "There is very little comparison that can be done between the two plans" following a cash balance conversion. Ex. 51 (quoting an actuary from the same consulting firm as AT&T's actuarial expert). "Changing to a totally different type of plan" lets you cut back "without being obvious about it." Id. (quoting another actuary from the same firm). AT&T's actuarial expert has written, "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 . . . ." Ex. 25 at 20. AT&T's actuarial expert identifies the transition provisions as the principal source of difficulty, stating that "most of the complexity is involved in the transition." Ex. 52 at 23.

171. The Plaintiff class' actuarial and communications experts analyzed the SPDs and other brochures in two steps. First, Mr. Poulin, the actuarial expert, analyzed the circumstances that can cause participants to lose benefits that they reasonably expected based on other descriptions of

benefits. With Mr. Poulin's report as his foundation, the communications expert (who is not an actuary) was able to analyze the SPD's and other brochures to see whether they disclosed the adverse features. Stratman Rpt at 4.

172. For communications expertise, the class retained James F. Stratman, Associate Professor at the University of Colorado at Denver and Director of its Technical Communications Program. Professor Stratman is an expert in the usability and understandability of written communication in legal, business and technical fields. AT&T's communications expert confirms that Professor Stratman has a "good reputation" in his field and is more experienced than she in the area of legal communications. Bosley Depo (100) at 16. Professor Stratman has written a law review article based on his research on ERISA SPD's on which the Third Circuit, as well as the Tenth Circuit, have relied. Stratman Rpt at 2-3.[3] In conducting his analysis, Professor Stratman employed findings from the "plain English" literature, experimental research on the shaping of expectations and the effect of framing propositions, findings on order of presentation and repetition of statements, and grammatical and linguistic analysis (such as testing alternative expressions, counter-exampling, identifying difficult "if then" constructions and vague pronoun references, e.g., sentences that do not reveal who the actor is). Stratman Depo (121) 123-32, 177-83. 193-200.

A. Mr. Poulin's analysis of the losses in benefits

173. Mr. Poulin first identified the circumstances that can cause losses in benefits that participants might reasonably expect to receive after the cash balance conversion. As discussed

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[3] Stratman, J. (1988), "Contract Disclaimers in ERISA Summary Plans: A Deceptive Practice?" *Industrial Relations Law Journal*, Vol. 10, No. 3, 350 - 380. Cited in *Alexander v. Primerica Holdings*, 967 F.2d 90, 93 (3d Cir. 1992), and *Chiles v. Ceridian*, 95 F.3d 1505, 1518-19 (10^{th} Cir. 1996).

above, Mr. Poulin found that the cash balance plan produces significantly lower rates of benefit accrual, especially at the older ages, than the prior 1.6% rate of accrual. Poulin Rpt ¶ 16.

174. He also found that the cash balance formula attaches a new contingency to the payment of the cash balance accruals depending on how the participant draws his or her previously earned benefits out of the plan. Id. at ¶¶30-33. The Plan's prior formula, by contrast, did not have any contingency on the payment of future accruals. Id. at ¶ 30.

175. Mr. Poulin further determined that the initial account balances that AT&T set up for participants represented only a fraction of the value of their already-earned benefits. The initial accounts did not represent the full actuarial equivalent of the previously accrued benefits at age 55, when they were most valuable. Instead, AT&T established initial accounts equal to a lump sum value of the participant's benefits deferred to age 65. Poulin Rpt ¶ 23. As a result, for employees close to age 55, the value of their initial account balances represented less than 50% of the actuarial present value of the benefits they were expecting to receive starting at age 55. Poulin Rpt ¶ 24.

176. Mr. Poulin's actuarial analysis further revealed that the table of conversion factors that AT&T used to establish the initial account balances was based on higher interest rates for older employees than for younger employees. He translated AT&T's tabular conversion factors into interest rates and found the interest rates were more favorable at the lower ages.

Age	Implicit Interest Rate
65	7.90%
60	6.11%
55	5.28%
50	4.85%
45	4.60%
40	4.37%
35	4.23%
30	4.19%

Poulin Rpt ¶ 26.

177. AT&T's actuarial expert prepared a spreadsheet that confirmed Mr. Poulin's analysis. Sher Depo (102) at 243-45 and 255-56 (describing Sher Ex. 5).

178. A 54 year old employee like Mr. Noerr would have received 20% more if the 4.19% interest rate applicable to a 30 year old employee had been used to convert his benefits to an opening account balance ($18,276 ÷ 12 x 87.86 instead of x 73.20). With that change in the conversion factor alone, Mr. Noerr's wearaway would have been two years shorter. Poulin Suppl. Decl. ¶ 2.

179. The 7.9% and 6.11% interest rates that Mr. Poulin uncovered in AT&T's conversion factors were also substantially higher than the prevailing ERISA Section 205(g) and Internal Revenue Code Section 417(e) rates used to calculate lump sum values. On January 1, 1998, the 30-year Treasury rate under Section 417(e) was 5.81%. The PBGC interest rate under the same section was 4.25%. The 2.1 to 3.65% higher interest rates produced lower initial account balances. Poulin Rpt ¶ 25.

180. In a May 2000 survey, AT&T's actuarial expert found that it is very unusual for a conversion to use an interest rate higher than the prevailing 30-year Treasury rate. Only 2 percent of the plans surveyed had used an interest rate of more than 2 percent above the Treasury rate. Ex. 24 at 21; see also Exh. 19, Tab A (PwC/Unifi survey) at 35174.

181. Because AT&T set the initial account balances below the value of the pension benefits that existed before the conversion and froze the accrual of benefits under all prior formulas, it created the period of time dubbed "wearaway" when the accruals or pay credits under the cash balance plan are merely catching up with where the participant already is. Under AT&T's design, it could take up to 13 years in some cases until the cash balance account exceeds the value of the pre-cash balance

benefit. Poulin Rpt ¶ 27.

182. Mr. Poulin found that the duration of the wearaway period is a function of the difference between the actuarial present values of the protected retirement benefits and the opening account balances. Id at ¶ 27. The duration of the wearaway is <u>not</u> a function of the increase in the amount of the age 55 monthly benefit. For example, Mr. Noerr's wearaway period would have been nearly the same even if there had been no Special Update. This is because the wearaway is based on the value of his early retirement subsidy, not the amount by which the Special Update increased his monthly benefit. Poulin Suppl. Decl. ¶ 1.

183. Mr. Poulin found that a period of wearaway is not an inherent feature of a cash balance conversion, nor is it legally required for any conversion. Over the years, a number of pension plan conversions have taken place without wearaway. See ¶ 48 . AT&T's Enrolled Actuary testified that this was the first conversion with a wearaway in which he had been involved. Gulotta Depo (93) at 19-20 and 192-93.

184. A wearaway can always be avoided by establishing initial account balances closer to the full value of benefits accrued prior to the conversion. It can also be avoided simply by protecting already earned benefits in annuity form and adding the benefits earned from cash balance to those benefits. This approach is variously described as the "A plus B" or the "sum of" approach. By comparison, AT&T's approach offered a choice of either: (1) A without B, or (2) for a participant like Mr. Noerr, approximately 50% of A plus B. Poulin Rpt ¶ 28.

B. Professor Stratman's analysis of the disclosures

185. Professor Stratman reviewed the SPD and other brochures and found that they "fail to disclose to the average plan participant the losses in benefits resulting from the new cash balance

plan":

> There is no language in these documents making explicit the circumstances under which the move to the new cash balance formula results in significant benefit losses.
>
> AT&T's SPD is a dense, opaque, and legalistic document which is very difficult for the average plan participant. The disadvantages of the cash balance formulas compared to the current formulas are never disclosed in an understandable manner. Instead the SPD and precursor documents exaggerate the advantages of the new formulas and consistently hide or render obscure the disadvantages. . .
>
> Neither the SPD nor precursor brochures disclose that AT&T is cutting benefit accrual rates. There is not even a hint that future benefits have been cut by 15% - 35% as described in the actuary's report. The SPD does not disclose that the initial account balance can represent less than one-half of the value of participants' benefits or that the conversion factors are not true actuarial factors. Instead AT&T indicates that the initial cash balances are "derived from" the undiscounted, updated benefits under the current plan formulas. In the section of the SPD that describes the cash balance plan's pay credits and interest credits, there is no description or cross reference to limitations on payments of these credits. AT&T does not disclose that a new benefit offset provision (as noted in the actuary's report) can reduce these accruals to zero. On the contrary, AT&T suggests that benefits will continue to grow "steadily." The discordant term "crossover point" mentioned in one precursor brochure does not appear in the SPD and is not explained or connected to the receipt of the pay credits described in the SPD.

Stratman Rpt at 1-2.

186. Professor Stratman reported that participants would not understand the reduced accrual rates that Mr. Poulin found from reading the SPD. Based on the information in the SPD, participants were not even able to calculate the age 55 annuity offered under cash balance in order to compare it with their age 55 benefit under the prior formulas. Stratman Rpt at 17.

187. Professor Stratman also found that the SPD never explained that AT&T was eliminating its schedule of unreduced pensions at age 55 and never offered participants the new schedule. Stratman Rpt at 23. In the presentation to the Board, the first reason for "Why Consider Cash Balance?" was to "Remove Early Retirement Schedule Provided in the Current Plan." Another slide talks about the need to address the Plan's early retirement schedule and bring it into line with

competition. Ex. 12 at 34262 and 34268. An AT&T memo with "off-the-record" material for "PR queries" states that "the most significant cost saving aspect of this change is the elimination of the large early retirement subsidy (allowing unreduced pensions for many people at age 55)." Stratman Rpt at 23 quoting Stratman Rpt Ex. 11.

188. Instead of disclosing the changes in the early retirement schedule, Professor Stratman found that the SPD referred participants to reduction factors that were not provided in the SPD and were not made available to participants. Stratman Rpt at 23.

189. Professor Stratman found no cross-references or other links, as the SPD regulations require, between the description of pay credits and interest and the circumstances that could cause the benefits from those credits to be entirely lost: "[W]hile the SPD is replete with cross-references, none of them connect restrictive plan provisions with descriptions of benefits." Stratman Rpt at 15 and 19.

190. The narrative and numerical description of pay and interest credits that runs from pages 3 to 5 of the SPD does not mention or cross reference any material indicating that the pay and interest credits are not payable at all if a participant retires early. Stratman Rpt Ex. 4.

191. Making payment of the new accruals contingent on giving up other benefits was a modification from the prior plan. Poulin Rpt ¶ 30. But the SPD did not identify this as a change.

192. Professor Stratman found that the SPD does not repeat the term "crossover" or attempt to explain it. Stratman Rpt at 2. The SPD has one sentence indicating that "<u>there may be instances</u> where the benefits available before Normal Retirement Age under the Plan's prior pay base averaging period formulas, which include the Special Update and the Frozen Accrued Benefit, are greater than the benefits available through the Cash Balance Account." AT&T never connects this

sentence up with the loss of pay and interest credits--potentially for up to 13 years. Professor Stratman also explains how the indefinite phrasing ("there may be instances") and complex sentence structure obscure or minimize the message. Rpt at 19-20.

193. The SPD contained no understandable disclosure that the opening account balances could be less than one-half of the value of the Special Update. Stratman Rpt at 18-19. Instead, Professor Stratman found disclosures in each of the earlier brochures indicating that the opening account balances included the value of the undiscounted age 55 Special Update. Stratman Rpt. Ex. 1 at 4, Stratman Rpt. Ex. 2 at 5 and 14; and Stratman Rpt Ex. 3 at 6. The SPD never disclosed that the opening cash balance account could be 45% of the value of the Special Update, as Mr. Sefcik revealed internally as early as December 1996. Ex. 64.

194. Even some corporate officers and high-level consultants had misconceptions about the crossover. Hal Burlingame, the Executive Vice-President for Human Resources, did not know whether it was a "necessary feature" of cash balance conversions to set up initial accounts at less than the value of the Special Update. Burlingame Depo (96) at 80-82. Adele Kellman, an experienced benefits consultant for ASA, did not know whether a wearaway was legally required, inherent in a conversion, or optional. Kellman Depo (99) at 35-38. AT&T's public spokesperson, Burke Stinson, believed he was under a grandfather provision. Ex. 38.

195. The class members who were deposed testified that they did not learn anything about "crossover" from AT&T's SPD or brochures. Jane Banfield testified that the literature "really [doesn't] tell you that you're going to be losing the benefits that you had before. . . I would never have understood this from this documentation." Banfield Depo (119) at 52.

196. The few class members who learned something about crossover did not learn from

AT&T's brochures, but from:

(a) using the cash balance modeler on the AT&T intranet (Smit Depo (111) at 182-3, Berger Depo (120) at 76 , Engers Depo (112) at 121-22, McFall Depo (114) at 73);

(b) noticing the major gap between their VRIP lump sum amounts and their cash balance accounts (Noerr Depo (116) at 73, DiCerbo Depo (117) at 49, Morse Depo (113) at 41-43 and 100-1); or

(c) talking with other employees or Plaintiffs' counsel (O'Brien Depo (115) at 66-67).

197. When employees realized that AT&T had actually "frozen" their pensions for the rest of their careers, there was "shock" and a "disbelief that AT&T could do this." DiCerbo Depo (117) at 58-59. Named Plaintiff Don Noerr wrote a letter to *AT&T Today* (AT&T's in house newsletter) on September 15, 1999 explaining that he only discovered the "major gap" between his traditional plan and the new Cash Balance account by using the VRIP tools (which went online in the Spring of 1998). Before that, he "took AT&T at their word and just assumed that AT&T was doing the right thing for me." Ex. 76. He only learned that he "was not going to improve [his] pension" when he "did the analysis associated with VRIP." Noerr Depo (116) at 73.

198. It is unlikely that many employees achieved this level of knowledge. AT&T's counsel represented to Professor Stratman that "large numbers" of employees e-mailed complaints about cash balance "within a week" after cash balance modeling tools were posted on the web in mid-November 1997. Stratman Depo (121) at 249-50. However, in discovery, AT&T produced e-mails from 45 individuals. Anderson Decl. ¶ 6. Some of the e-mails are very perceptive:

• "Comparing the cash balance plan to the "frozen" [Special Update] amount is like a car race where one of the cars is stopped."

• "New employees who have no or little vestment in the old plan will be receiving value from day one of the new plan."

• "I do not understand why people in my situation (and there are many) aren't given an

> account in the NEW plan with a ZERO starting balance to accrue some additional value during the working years past 1997."

Ex. 78 at 586, 603, and 583. But the number is small in relation to the over 57,000 participants in the plan--less than 1/10th of 1 percent. This is not enough to indicate that AT&T communicated "in a manner calculated to be understood by the plan average participant." 29 C.F.R. 2520.102-2(a) and 26 C.F.R. 1.411(d)-6, Q&A 10. The persons who handled telephone calls in November 1997 also observed that the "majority of the callers have absolutely no idea of what the changes mean to them or how it will affect their retirement" whereas the "minority of the callers" who "understand the plan" are "usually upset." Ex. 78 at 16475.

199. In 1997, access to AT&T's intranet was limited. Bosley Rpt Ex. 8 at 6276 ("you can't get in unless you're behind the firewall" and "some people don't have access to the Web"). Some employees were not comfortable using internet modelers without assistance. DiCerbo Depo (117) at 103.

200. Professor Stratman found that AT&T's disclosures did not direct employees to the intranet for information about crossover. Stratman Rpt at 12-13 and Stratman Depo (121) at 324-29. The SPD mentioned the Web Site in an Appendix; it did not direct employees to it to learn more about crossover or other bad parts of the cash balance plan. Stratman Rpt Ex. 4 at 39. Once in the intranet site, there were multiple options only one of which had a footnote about crossover. Ex. 58.

201. The specification of crossover year in the footnote to the cash balance modeler that appeared on AT&T's intranet in mid-November 1997 was "Blanked out on [a] new version" shortly after it appeared. Ex. 56. Mr. Sefcik testified that the modeler was reprogrammed to display crossovers on an "immediate" basis, with the footnote "blanked out" otherwise. Sefcik Depo (91) at 121-23. After the new version was installed, the crossover footnote no longer appeared for

employees like Bonny Berger who had extremely lengthy wearaways but were under age 44. See Ex. 45 (computing crossover on "immediate" basis "no one below 44 has any). The reprogramming also shortened the crossover period for individuals over that age because it was more "conservative." Id. Individuals who modeled their cash balance benefits as of commencement date beyond the crossover period no longer saw a footnote, even though their benefits were still be frozen for a number of years.

C. The managers asked AT&T to disclose whether cash balance "reduces benefits"

202. Focus groups of managers, HR leaders, and individual employees requested disclosures about whether cash balance "reduces benefits" and comparisons of the old vs. the new benefits. As mentioned, the focus groups repeatedly asked AT&T to provide comparisons and be honest if cash balance "reduces benefits." See ¶¶ 104-5. They further asked for the basis for the conversion factors used to establish the initial account balances: "What is the logic behind the conversion factor?" "Is it secret?" Stratman Rpt Ex 8 at 14678 and Ex. 84 at 16234 and 16239.

203. An internal write-up indicates that HR Leaders raised the same question about the conversion factors in 9/25 and 9/26/1997 cash balance seminar previews: They asked, "Is it a secret?": The answer was "No, however it is a very technical explanation-most people may not understand. Ken trained AYCO counselors on this question and they had some difficulty." Ex. 84 at 16239; and see id. at 16234. The script used by the AYCO speakers anticipates the same "question" about the "actuarial assumptions used to arrive at the conversion factors." However, the scripted response does not answer it. Ex. 34 at 35404.

204. Other individuals asked the same question. AT&T's records show that this was a common question from employees who telephoned in November 1997. Ex. 78 at 16477. Named

Plaintiff Gerry Smit wrote a November 18, 1997 letter asking about the basis for the conversion factors which was never answered. Ex. 57 and Smit Depo (111) at 158. Gary Morse, a member of the class who was deposed by AT&T, testified that he called about how the opening account balances were determined and was not able to get any information. Morse Depo (113) at 99-100.

205. A December 23, 1997 memorandum memorializes AT&T responses to questions from union representatives about "how the [conversion] factors were determined" for the management employees. In it, AT&T admits "there was no true actuarial basis and that the factors were determined taking into account legal parameters, replacement targets, crossover periods, etc." Ex. 59 at 2.

206. Once AT&T told the union representatives that the conversion factors for the managers had "no true actuarial basis," they were able to obtain a grandfather provision for older, longer service employees and better conversion factors for all employees in an agreement announced May 11, 1998. With the grandfather provision, Mr. Noerr would have no wearaway. With the improved conversion factors, Mr. Noerr's period of "wearaway" would have been two years instead of five. Poulin Suppl. Decl. ¶ 3; and compare Ex. 60 at 224 with Ex. 5 Appendix B (105.36 vs. 73.20 conversion factors for individual age 54).

207. Likewise, the VRIP announced in January 1998 modified the AT&TMPP to provide age 54 employees like Mr. Noerr with a conversion factor of 147.71 (157.14 x (1 - 6%). Ex. 61. According to AT&T's financial and actuarial reports and communications with employees, these factors were designed to give participants the "full value" or the "entire value" of their Special Update annuities. Ex. 27 at 26376 and 26401 and Ex. 62 at Q&A 16. They, too, would have eliminated any wearaway. Poulin Suppl. Decl. ¶ 4.

208. Even if these conversion factors were not legally required to be applied to Mr. Noerr, they show that AT&T knew that it was applying unfavorable conversion factors to the older managers and did not want to disclose it. The different sets of conversion factors that were under consideration as late as February 28, 1997 (one of which would have raised the conversion factors from ages 44 to 54) also show the AT&T design team's awareness of the "bad parts" of the cash balance design. Exs. 65 and 66.

209. AT&T withheld disclosures and comparisons that would have revealed the "large" differences between the initial account balances and the full value of the Special Update annuities. As mentioned, Kenneth Morgan directed the communications team to "reconsider comparing special update and cash balance annuities" because the special update will be "significantly large[r] for the "vast majority of participants." Stratman Rpt. Ex. 9. Mr. Morgan also testified that there was "no need to disclose" the lower values of the opening balances in the SPD. Morgan Depo (90) at 178 - 79. In communications meetings, AT&T and ASA questioned "Why would we want to tell people that the special update is higher than Cash Balance?" Stratman Rpt Ex. 6 at 17693. The minutes reflect AT&T's position that "We can't tell [participants] the bad parts upfront. Need to sell cash balance. Do we want to explain the crossover or sell Cash Balance?" Id.

210. Although this was among the first cash balance conversions with which ASA had been involved with wearaway, Gulotta Depo (93) at 19-20 and 192-93, AT&T and ASA knew that the design was producing very long wearaways with no accruals for older, longer service employees. In June 1997, Ken Willetts, the main seminar speaker for AYCO, wrote that a 9-year crossover "seemed like a long time to me." Ex. 68. Mr. Willetts later testified in the Peterson v. AT&T case that it could take up to 11-12 years for benefits to be better under Cash Balance. Willetts Depo (110)

at 134-5. Communications meeting minutes show that AT&T knew that "employees in 40's (C & D bands) could lose[,] have to wait 10 years for benefits." Stratman Rpt Ex.6 at 17825. In Bonny Berger's case, the modeler (before the "blanked out" version) projected her wearaway to be 13 years. Poulin Rpt. Ex. I. Named Plaintiff Gerry Smit, who had a 9-year wearaway, was told that only "15 year or more crossover upsets them" Ex. 81.

211. In June 1998, AT&T entered into a special agreement to transfer trust assets from the AT&TMPP to a new cash balance plan to be established for the AT&T/ASA employees, including Messrs. Gulotta, Basu, Morgan, and Sefcik, the principal designers of the cash balance features. Under the Agreement, they were all given at least the full value of their Special Updates as their starting account balances. Poulin Suppl. Decl. ¶ 5; and Gulotta Depo (93) at 134-37 and 203-5. Under the amendments that were adopted on October 16, 2000, the AT&T/ASA employees would have been relegated to choosing between receiving either their Special Update annuity as a frozen benefit or a cash payment based on a significantly lower annuity. Instead, they were offered at least the full value of their Special Update benefits. After reviewing the ASA Employee Benefits Agreement, Magistrate Judge Hedges found that assets were transferred from the AT&T Management Pension Plan to ASA to enable it to fund "a greater opening balance than AT&T's." Letter Opinion and Order by Magistrate Judge Hedges, entered May 20, 2004. In his Supplemental Declaration, Mr. Poulin finds that ASA employees may have received between 200% and 400% of their opening balances under the AT&T cash balance plan. Poulin Suppl. Decl. ¶ 5.

212. A transfer of assets to a party-in-interest on terms that are more favorable than those available to other employees is a prohibited transaction under ERISA § 406(a)(1)(D), 29 U.S.C. 1104(a)(1)(D). DOL Adv. Op. Ltr. 81-30A provides that the restriction provided in ERISA

§408(c)(1) applies to a transfer of assets to a party in interest for benefit payments. ERISA 408(c)(1) provides that insiders may receive benefits from the plan, but only "so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries." ERISA § 408(c)(1); *Donovan v. Daugherty*, 550 F.S. 390, 410 n.22 (S.D. Ala. 1982) (finding that benefits for trustees were not "computed and paid on the same basis as those provided for the other participants and beneficiaries"). It is undeniable that ASA is a "party-in-interest" under ERISA § 3(14).

213. The exception that was created in May-June 1998 for the AT&T/ASA employees shows that the fiduciaries and parties-in-interest knew that AT&T's wearaway was so "bad" that they personally had to avoid it–even if this required them to take unlawful actions to improve their own benefits. The transfer of the entire value of the ASA employees' accounts let them establish opening account balances under their own cash balance plan that were substantially greater than those offered to other AT&T employees. Poulin Suppl. Decl. ¶ 4; Ex. 23; Gulotta Depo (93) at 134-37 and 203-5.

D. If the adverse features are "true," AT&T and its experts do not contest that the SPD does not disclose them

214. Brian Byrnes was designated to testify under Rule 30(b)(6) about AT&T's disclosures of cash balance features to participants. Ex. 82. He testified that the SPD does not disclose that:

(a) The initial cash balances are less than full value, Byrnes Depo (92) at 145 (and see Byrnes Depo (109) at 66 in Peterson: "we started the Cash Balance at a lower value"); or

(b) The pay credits are conditional, Byrnes Depo (92) at 149-51.

215. In answer to interrogatories, AT&T asserted that it did not disclose that actual benefit accruals under the cash balance design will not materialize until the "crossover" year is reached because it is "not true." AT&T also asserted that it did not disclose that the rates of benefit accrual

under the new cash balance plan decrease with age because it is "not true." Ex. 17, Tab A (Ans. to Int. No. 20 addressed to AT&T).

216. Michael Gulotta, the Plan's Enrolled Actuary, agrees that the rates of accrual are less and agrees with Professor Stratman's finding that the disclosures do not "clearly tell me that the cash balance accruals are less." Gulotta Depo (93) at 169-71.

217. AT&T's actuarial expert did not contest Mr. Poulin's analysis of the losses incurred under the cash balance design, but offered legal opinions that the features that Mr. Poulin identified were not unlawful per se. Ex. 3 (Sher Rpt) at 16-27.

218. AT&T's communications expert, Professor Deborah Bosley, conceded that her report did not analyze whether AT&T disclosed the losses that Mr. Poulin identified, and therefore she could not rule out Professor Stratman's analysis of the disclosures. She said that because she did not know if Mr. Poulin's analysis was "true," her report did not analyze whether AT&T disclosed any of those points. Bosley Depo (100) at 233-39. If her expert opinion on the adequacy of AT&T's disclosures is a necessary part of AT&T's burden of proof, AT&T has foregone the opportunity to offer expert evidence in its favor.

219. Another communications expert, Mark Johnson, admitted that he was not testifying as a communications expert. Johnson Depo (101) at 183-86. As a fallback, Mr. Johnson contended that he could testify as a "benefits professional" with knowledge of "industry practices," but he admitted he had no professional experience with disclosures about benefit reductions or benefit options with unequal values and had never seen a Section 204(h) notice (other than a quotation from one in a GAO report). Johnson Depo (101) at 66-68, 70, 121-23, 275.

E. The experts agree that understandable disclosure of adverse features is not difficult

220. Professor Bosley's testimony that understandable disclosures of benefit reductions are not difficult has already been discussed in ¶ 131. Professor Stratman's report indicates that AT&T could have compared the old and the new accrual rates in a similar manner to the spreadsheets, graphs, bar charts and other comparisons that AT&T prepared but kept "Confidential." Stratman Rpt at 17.

221. The same applies to disclosures about the periods of wear-away with no accruals: AT&T could also easily have disclosed that the initial account balances did not represent the "entire value" of their benefits. Compare Ex. 62 (Q&A 16). AT&T could have disclosed that the pay credits and interest for that period are merely bookkeeping entries that will not actually be paid to many employees who retire early. Honest comparisons of the cash balance annuity with the Special Update annuity at age 55 could have been provided: AYCO's RoadMap software offered apples-to-apples comparisons of Special Update vs. Cash Balance annuities. Ex. 70 at unnumbered page entitled AT&T Pension Options.

222. AT&T's expert, Professor Bosley, admitted that understandable disclosures of these features would not be difficult. Bosley Depo (100) at 243-44.

F. AT&T used bulk mail to distribute the SPD

223. AT&T submitted its January 1998 SPD to Judge Politan with a December 2, 1998 Certification. Named Plaintiff Gerald Smit, who was then representing the class pro se, recognized that he had never received the SPD and asked co-workers if they received one. Smit Depo (111) at 195-200. Donald Noerr filed a Declaration in this case dated February 8, 1999 attesting that he had never received the SPD. Ex. 71. Subsequently, Mr. Smit received the SPD in the mail on September

25, 1999. Ex. 75. The SPD arrived in an envelope which indicated it was sent by bulk mail. Id. The numbers on the envelope suggested that it was part of a bulk mailing of up to 100,000 items. Maroney Depo (104) at 27-32.

224. Mr. Smit's belated receipt of the SPD suggested that a supplemental mailing may have been conducted to cover individuals who were omitted from the original mailing. However, AT&T's mailer said it would take hours of research to determine if there was any supplemental mailing of the SPD and conjectured that this could simply be a late delivery from the January 1998 bulk mailing. Maroney Depo (104) at 27 and 36.

225. Two of the four named plaintiffs did not receive the SPD (see ¶223), and the other two could not recall (McFall Depo (114) at 81-83; Engers Depo (112) at 129-32). Of the ten named Plaintiffs and other class members who AT&T deposed, only three testified that they received the SPD in the mail in January 1998 (Dobbins Depo (118) at 58-59, Berger Depo (120) at 46 and Banfield Depo (119) at 82-83).

226. An ad hoc survey on the Internet found that 34% of 647 participants who responded did not receive the SPD. Anderson Decl. ¶ 4-5.

227. AT&T used bulk mail to deliver the SPD because it offered the company a 68% savings over first class mail. Ex. 72 at 7726. However, as Professor Stratman observed, "In the communications field it is well-known that bulk mail delivery is not as reliable as first class and that bulk mail is less likely to be opened or read because it is considered less important." Stratman Rpt at 16. AT&T's mailer acknowledged that his wife throws out bulk mail without opening it and he only opens it because he has a professional interest in how these things are put together. Maroney Depo (104) at 87.

228. The Plaintiff class subpoenaed AT&T's mailer, who continues to have a significant business relationship with AT&T, to see if there was an unusual number of returns and misdeliveries of the SPD and to see whether returns were readdressed and redelivered. During an on-site deposition, the mailer located "job envelopes" for the cash balance mailings, including the SPD, but he could not locate the "job envelopes" related to returns and forwarding which would show whether returned mail was sent again by first class or personal delivery. The mailer stated that those job envelopes for the returns should exist and had "no theory" to explain their absence. Maroney Depo (104) at 58-59 and 82-3.

VIII. The Disclosures in AT&T's SPD and Benefit Election Materials About the Lower-Valued Benefit Options

229. Mr. Poulin reviewed AT&T Management Pension Plan Pension Payment Election Forms, which were attached to his Report as Exs. H and I. He found that AT&T was asking participants and their spouses to elect cash payments and give up lifetime annuity benefits with <u>no disclosures</u> when the annuities had higher values. Participants were given four choices with no information to tell them if the third and fourth choices were clearly less valuable than the others. Poulin Rpt ¶¶ 36-37.

230. For example, Edward O'Brien's Pension Payment Election Form showed that the single life annuity to which he was entitled at the age of 50 years and two months was $999.65 and the 50% Joint and Survivor Annuity at the same age was $899.69. Poulin Rpt. Ex. H. However, Mr. Poulin found that the cash option presented to Mr. O'Brien was substantially <u>less valuable</u> than the annuity options. Based on the factors found in the AT&T Management Pension Plan, the cash option corresponded to a single life annuity of only $726.34 a month. In other words, Mr. O'Brien would have received 38% more by electing the first or second annuity option. Comparisons of the relative

values of these various options were not presented to him in a meaningful narrative, percentage or numerical form. Poulin Rpt ¶ 36.

231. Mr. Poulin found that Bonny Berger's Pension Payment Election Form did not even present what was her most valuable option, which was a pension benefit of $1,672.63 a month beginning at age 55. All the options shown on her election form were based on her Cash Balance Accrued Benefit of $2,058.16 at age 65, which was the actuarial equivalent of a pension benefit of only $1,173.59 at age 55. Ex. I. Ms. Berger was, however, entitled to a pension benefit of $1,672.63 at age 55 under the prior formula, which was worth 42.5% more than the options described in her Pension Payment Election Form. Comparisons of the relative values of the various options were not presented to her. Poulin Rpt ¶ 37. As described earlier, Mr. Poulin also offered his opinion that AT&T's disclosures about the 6% per year reduction were inaccurate and misinformed. ¶¶ 164-65. Mr. Byrnes, AT&T's Rule 30(b)(6) witness agreed that the SPDs and other brochures do not disclose "in so many words" that the 6% per year reduction is excessive. ¶ 166.

232. At his deposition, Mr. O'Brien testified that he thought the options that AT&T presented to him in the benefit package had equal values and he decided to go with the cash payment option because it gave him the ability to grow his benefits. He did not know that the annuity option had a greater value until "within the last year." O'Brien Depo (115) at 47-48.

233. Ms. Berger testified that she elected the cash payment option because she believed she could earn more than the 4% interest credit rate that AT&T guaranteed under the cash balance plan. She did not know her most valuable benefit option did not even appear on the election sheet. She thought the "whole story" was on that piece of paper. Berger Depo (120) at 113.

234. Professor Stratman found that the circumstances under which benefit elections can cause

losses were <u>not</u> disclosed in the SPD or the benefit election materials. His examination found that:

> The 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. . .
>
> The relative values of the benefit options that participants are offered are not explained either in the SPD or in the benefit election package. There is no disclosure that some of the options are clearly less valuable than others, or that the cash option results in the loss of entitlement to the special update. Instead AT&T suggests that elections are just a matter of individual preference and circumstances. The SPD does not tell participants that the 6% per year reduction for retirement before age 55 is not a reasonable actuarial reduction. Instead, AT&T suggests (inaccurately, according to the actuary's report), that a 6% reduction leaves a participant who starts benefits before age 55 with the same "overall value."

Stratman Rpt at 2.

235. AT&T was aware from an early stage that there were disclosure issues related to benefit options. A member of the communications team objected to a draft statement for the April 1997 letter that employees will "know the "exact value" of their account" under cash balance "because the amount could go up depending upon the option the employee selects." Ex. 73 at 17794. AT&T nevetheless offered no disclosures about the relative values of options. Indeed, the November 1997 cash balance brochure contains an approving example where a fictional employee named "Bill" is "inclined to take his pension as a cash payment." The brochure does not explain, or hint, that Bill would be choosing a less valuable option. Stratman Rpt Ex. 3 at 26.

236. AT&T's actuarial expert did not disagree with Mr. Poulin's actuarial analysis of the relative values of the benefit options and only offered legal opinions or opinions from his "experience" about whether more complete disclosures are common. Sher Rpt at 27-33.

237. AT&T's designated Rule 30(b)(6) witness on disclosures, Brian Byrnes, acknowledged that the SPD and other brochures do not disclose that the 6% reduction may be actuarially excessive. Byrnes Depo (92) at 131-32 and 154-56.

238. The report of AT&T's communications expert, Professor Bosley, does not address whether the SPD or benefit election materials adequately disclose the potential losses under the benefit options. Bosley Rpt at 44-50. AT&T's other expert, Mark Johnson, conceded that he did not have any experience with benefit elections where options have unequal financial values. Johnson Depo (101) at 70 and 121-23.

239. AT&T and ASA were aware that some of the immediate benefit options were "clearly less valuable." Ex. 74 at 4861. Discovery shows that AT&T concluded that it could "legally offer a distribution" that was "clearly less valuable" than another option only after some disagreement. Id. Once this conclusion was reached, AT&T next decided that it would be "sufficient" for an "informed election" for the benefit election materials to disclose only the single life annuity payable at the normal retirement age. The discussion about what an employee "needs to know" to make an "informed election," was resolved by the opinion of Kenneth Morgan, AT&T's in-house lawyer, that "it is sufficient to show the single life annuity payable at the normal retirement age." Ex. 74 at 10723.

240. At his deposition, Mr. Morgan referred to a "plethora of regulations" and was unsure what the "relative value" of a benefit option means. Morgan Depo (90) at 128 and 276-92. He testified that he believed a participant could take a calculator and do a "real quick calculation" to figure out which of the options was more valuable. Morgan Depo (90) at 279-83. At his 30(b)(6) deposition, Brian Byrnes also suggested that participants could "realize" the differences in value with a "calculator." Byrnes Depo (92) at 121-2. But no warnings were given to employees that their benefits options potentially had unequal values and no instructions were offered on how to do such "calculations."

241. Since 1997, tens of thousands of AT&T employees have lost their jobs. These employees have been sent benefit commencement packages that fail to explain the relative values of their options, or that deferring commencement to age 55 can be the more valuable option (because of the actuarially excessive 6% reduction before age 55). As indicated, 24,405 former employees on the Class List have commenced their retirement benefits, 19,454 of whom commenced benefits before age 55, which subjected their benefits to the 6% per year reduction. Ex. 50. The actuarial report attached to AT&T's Form 5500 Annual Report shows furthermore that AT&T's actuary "assumes that <u>70%</u> of employees elect the lump sum under the cash balance plan." Ex. 27 at 26378. Employees like Dollie Dobbins who left AT&T under the VRIP in 1998 were never told that the 20% incentive was being combined with an excessive reduction for early commencement.

242. Instead of disclosing potential losses from commencing benefits early, AT&T's August 1997 brochure suggested that participants receive the "same" "overall value" even if they commence benefits before age 55 subject to the 6% per year reduction. The brochure states that the "overall value of your pension likely will remain the same" if you start receiving payments before age 55. A footnote qualifies this sentence only slightly by stating that the "value remains same on average."

243. A graphic on the same page shows a dollar being stretched for retirement before age 55. Stratman Rpt Ex. 2 at 8. Focus groups conducted by AT&T showed that the groups understood that the graphic "tells you how the pension discounts work." Bosley Rpt Ex. 8 at 6259, 6271 and 6277.

244. AT&T assured employees that they could not lose anything through a benefit election because they were always going to be entitled to the "highest benefit." The SPD states that you'll always receive the "highest benefit that applies to you." Stratman Rpt Ex. 4 at 5. The November 1997 cash balance brochure also assures employees: "You will be eligible for the highest benefit

that applies to you." Stratman Rpt Ex. 3 at 5.

245. As a "defense," AT&T and its experts profess not to understand "value." Byrnes Depo (92) at 118-19 ("what's of value to an individual is that individual's determination"); Sher Depo (102) at 268 (which option is "most valuable " depends on individual circumstances); Bosley Depo (100) at 165-68 (value is a "subjective term"); Johnson Depo (101) at 119-20 (value is a "transcendental" term). They argue that AT&T could not comply with the Treasury Department's regulation on disclosing "relative value" because it does not know what "value" means to each participant. They contend that because value can depend on "individual circumstances," it is impractical or impossible to communicate relative value. Id.

246. In brochures and other written materials, AT&T has, however, repeatedly demonstrated that it is fully capable of making disclosures related to the "value" of benefits:

(a) The April 1997 letter represents that the cash balance will make it easier for participants to understand the "total value" of their employment at AT&T. Stratman Rpt Ex 1 at 1.

(b) The brochure on "Your Pension Improvement" makes specific representations about the "overall value" of the benefit options. Stratman Rpt Ex 2 at 8.

(c) The brochures reinforce the theme that cash balance will help participants "understand– and better–value their pension benefit." Stratman Rpt Ex 2 at 3. A chart in the brochure entitled Your New Cash Balance Account plots "benefit value." Stratman Rpt Ex 3 at 3.

(d) Descriptions of the VRIP prepared by AT&T state that it offers employees the "entire value" or the "full value" of the Special Update in a lump sum form. Ex. 62 at Q&A 16 and Ex. 27 at 26376 and 26401.

247. Alternatively, AT&T's actuarial expert suggests it can sometimes be "misleading" to tell a participant that a cash payment option has less relative value than an annuity when the participant has a shorter life expectancy, e.g., due to of "a family history of cancer and heart disease." Sher Rpt at 28-30. While the regulations permit plans to disclose that relative values can be different

if an individual has a short life expectancy, the regulations do not authorize this to serve as an excuse for non-compliance.

248. Finally, AT&T's expert suggests that "everyone does it," that is, that other companies have ignored the disclosures about relative value that the regulations required beginning in 1989. Mr. Sher represents that "in his experience," other "employers have opted not to try to provide part of the picture" because the relative value disclosure is "rather simplistic." Sher Depo (102) at 267-70. Mr. Sher revealed in another deposition that when he refers to a "common practice" he means "it's not just a few," but not necessarily that it is a "predominant" or "majority" practice. Sher Depo (103) (in Amara v. Cigna) at 213.

249. Informative disclosures about the relative value of the benefit options would not be difficult. Professor Stratman describes how AT&T's Your Pension Improvements brochure already addresses value. AT&T could have used the same format, with more accurate information, in the SPD and the benefit election materials. Stratman Rpt at 9-10.

250. Professor Stratman also suggested that the language from internal communications could have been used in which employees and consultants talk with each other about how the cash options were "clearly less valuable." Stratman Rpt at 24. An internal memo that AYCO prepared explains how "the Special Update would provide a higher benefit" except in certain individual circumstances, e.g., "someone who is in bad health" or who "needs the money." Id. The "RoadMap" software program that AYCO offered for sale likewise contained disclosures about relative values. It said that the benefit under the Cash Payment Option "may be lower than an annuity you could have received by choosing a payment option payable from the Special Update." Ex. 70 at unnumbered page entitled Payment Options.

251. Professor Bosley conceded that she had not examined AT&T's disclosures about the relative value of benefit options based on the assumption that Mr. Poulin's analysis is true. Bosley Depo (100) at 246.

252. Hal Burlingame, AT&T's Executive Vice-President for Human Resources, testified that he thought AT&T would "point out [any lesser options] to them" and not let anyone choose the "lesser of the two." Burlingame Depo (96) at 163 and 165.

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