GROOM LAW GROUP

MEMORANDUM TO CLIENTS

June 2, 2006

Re: Split in Recent Cash Balance Plan Rulings

Recent rulings in the pending class action lawsuits against the FleetBoston and AT&T cash balance plans add to the growing number of decisions regarding age discrimination and other attacks on such plans. In Richards v. FleetBoston, D. Conn., No. 3:04-cv-1638 (JCH), 3/31/06, the U.S. District Court in Connecticut ruled that the basic cash balance benefit formula violates the age discrimination rules, making it the first court since the district court in the IBM case to come to such a conclusion. In Engers v. AT&T, D.N.J., No. 98-3660 (JLL), unpublished 3/31/06, the U.S. District Court in New Jersey dismissed a number of claims pending against the AT&T cash balance plan. While many of the most recent decisions, including the decision in AT&T discussed below, have come out in favor of the legality of cash balance plans (for example, the decision in favor of the PNC cash balance plan last fall, Register v. PNC, E.D. Pa., No. 04-CV-6097 (LDD), 11/21/05), the ruling against the FleetBoston Plan is a blow to plan sponsors.

A. FleetBoston Decision

In FleetBoston, the court considered a preliminary motion to dismiss claims involving a number of issues, the most significant being that the cash balance plan formula violates age discrimination rules. Other pending claims include allegations that Fleet failed to provide advance notice of plan changes as may be required by section

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204(h) of ERISA, the plan's SPD was insufficient because it did not describe the age discriminatory impact of the cash balance formula and the possibility of "wear-away," and the wear-away period caused the benefit accrual pattern to violate the anti-backloading rules.

1. Age Discrimination

Like claims in many cash balance plan cases, the FleetBoston participants claim that the cash balance formula is age discriminatory because pay credits made to younger employees will have more time to grow with interest than similar credits made to an older employee's account. ERISA section 204(b)(1)(H) requires that the "rate of an employee's benefit accrual" under a defined benefit plan cannot be reduced because of the attainment of any age. The issue that courts must resolve is how to measure the rate of accrual. Plaintiffs claim that the rate of accrual must be measured by the change in the benefit expressed as an annual benefit commencing at normal retirement age – an analysis which requires the inclusion of all future interest credits (to normal retirement age) with respect to a current pay credit made to the participant's account. Under this approach, the cash balance formula can be viewed as age discriminatory. Plan sponsors contend that the rate of accrual should be measured based on the change in the account balance from year to year – like a defined contribution plan. Under this approach, the cash balance formula is not age discriminatory.

The court in FleetBoston concluded that the statutory language "rate of benefit accrual" refers to the rate of change in the participant's "accrued benefit." In

turn, the term "accrued benefit" is defined by ERISA as the participant's annual benefit commencing at normal retirement age. The court refused to consider that legislative history may not support this conclusion and that the U.S. Department of Treasury (the agency charged with interpreting this section of ERISA) has consistently indicated that the statute should not be read in this manner for cash balance plans.

The FleetBoston decision is consistent with the widely publicized district court decision against the IBM cash balance plan, which is currently before the Seventh Circuit Court of Appeals. A decision on the IBM appeal could come at any time. Most other courts have concluded that cash balance plans (including the plans of PNC, CBS, ARINC, Southern California Gas and Onan Corporation) do not violate these age discrimination rules. Thus, regardless of how the IBM appeal turns out, this issue is likely to remain the subject of litigation for the foreseeable future unless a legislative solution is found. The pending House and Senate pension bills include differing provisions in this area and it is unclear what compromise will emerge.

2. Other Issues in FleetBoston

The court refused to dismiss two other claims made against the FleetBoston plan: (1) that Fleet failed to provide a notice as required under ERISA section 204(h) before implementing the cash balance benefit, and (2) that the summary plan description ("SPD") did not describe the possibility that wear-away could occur and that the cash balance benefit could be age discriminatory. The court allowed the 204(h) notice claim to proceed because the facts regarding its content and the timing of its distribution were not yet established to the court's satisfaction. As for the SPD, the

court held that the plaintiffs' allegations were sufficient to meet the "likely prejudice" standard for claims alleging that SPDs do not meet the requirements of ERISA. Both of these issues will require the court to review further the specific language of the 204(h) notice and the SPD, the relevant standard of disclosure for both items, and whether any failure to properly disclose may be cause for damages.

The court did dismiss, at least preliminarily, the plaintiffs' claim that the wear-away period that occurred following the cash balance conversion caused the plan to violate the anti-backloading requirements of ERISA. Citing ERISA section 204(b)(1)(B)(i) and the recent PNC decision, the court found that the backloading requirements are applied by considering the cash balance benefit formula on a stand-alone basis, without consideration of any wear-away caused by the transition from the old benefit formula. However, the court gave leave to the plaintiffs to brief this issue further if the plaintiffs so requested (and we understand the plaintiffs have made this request).

B. AT&T Decision

In the long-running class action suit against the AT&T cash balance plan (first filed in 1998), the federal district court in New Jersey recently granted partial summary judgment in favor of AT&T on claims involving the alleged failures (1) to provide a proper notice to participants under ERISA section 204(h), (2) to set forth the plan's "wear-away" rule in the written plan document, and (3) to disclose in the plan's SPD the "bad parts" of the cash balance conversion.

204(h) Notice – The court in AT&T reviewed the section 204(h) requirements and concluded that, although the statutory provision requires the notice where there is a significant reduction in the *rate* of future benefit accrual, the proper threshold determination under the controlling regulations was whether there had occurred a significant reduction in the *amount* of normal retirement benefits. Expert testimony was provided that none of the named plaintiffs would experience a reduction in the amount of benefits payable at normal retirement. In fact, each plaintiff's post-amendment accrued benefit was projected to be higher than under the pre-amendment plan. The court, therefore, determined that a 204(h) notice was not required.

Wear-Away – The plaintiffs claimed that the wear-away period (during which benefits may not accrue because the new cash balance benefit does not yet exceed the frozen prior benefit) was not expressly set forth in the plan document in a timely manner. The court held that the claim involved the interpretation of the terms of the plan document to determine whether wear-away was, in fact, properly required. The court concluded that this determination must first be made under the plan's claims procedures. Because the plaintiffs had not followed the plan's claims procedures, this claim was dismissed (without prejudice) for failure by the plaintiffs to exhaust their administrative remedies.

Misleading SPD – The plaintiffs contended that the SPD for the AT&T plan was misleading in that it overemphasized the "best" features of the plan and deemphasized the "worst" features of the plan. In particular, the plaintiffs claimed that the SPD did not properly disclose that, among other things, benefits for older employees

may be reduced, the factors used to determine the opening cash balance benefit were not the most valuable factors that had applied under the old plan, and that the new plan did not provide any early retirement subsidies. The court held that remedies would be available for a failure to comply with ERISA's reporting and disclosure requirements only if the plaintiff could demonstrate "extraordinary circumstances." AT&T may have put a favorable "spin" on the description of the benefits of the cash balance plan, but that did not rise to the level of "active concealment," which would be required to show extraordinary circumstances to support a claim for a substantive remedy.

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We will continue to closely monitor developments in this area. We are also actively involved with litigation and legislative activity on cash balance plan issues. Please contact Mark Lofgren, Chris Rillo or Bill Sweetnam if you would like to discuss these issues.

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