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Memorandum

PLEASE REFER TO OUR FILE NO.

To: Jelger Kalmijn

From: Arthur Krantz
Peter Saltzman

Date: March 10, 2006

Re: Legality of Changes for LANL Employees and Retirees

We have reviewed the February 13, 2006 Mercer Report entitled "LANS Total Compensation Design and Strategy" (Proposal to NNSA, Revision 1) and related documents concerning the UC-LANS proposals to restructure compensation and benefits for LANL employees and retirees. This brief memorandum will outline our initial concerns about the legality of the various changes being implemented for LANL employees and retirees with vested benefits under the UCRP.

I. Current/Transferring Employees

In essence, LANS is offering current employees a choice of either (1) terminating their employment, or (2) ceasing their participation in (and relinquishing all vested rights under) the UCRP benefit plans and carrying their credited service under those plans over to certain private sector plans to be established by LANS in accordance with the proposed "Total Compensation Package 1" (TCP1.)¹ As indicated below, we believe that this Hobson's choice raises serious concerns under Section 510 of ERISA and the Older Workers Benefit Protection Act.

¹ The Report describes a third "option": an employee can continue to participate in, but cease accruing benefits under, the UCRP and accrue all future benefits under the so-called "Pension Plan 2" (PP2). Because PP2 is a significantly poorer pension plan – providing benefits that are approximately 75% of the value of UCRP benefits, this "option" would only be selected by those current employees already prepared to retire from LANL employment. This option is, therefore, essentially equivalent to the first option above.

Although the Mercer Report describes the benefit plans in TCP1 as "substantially equivalent" to the UCRP Plans, it is clear that there are several significant differences. For example, "Pension Plan 1" (PP1) provides fewer opportunities for employee (pre-tax or post-tax) contributions, eliminates valuable buyback and reciprocity provisions, lowers the compensation limits for members active before July 1, 1994, permits fewer payment distribution options, and will likely eliminate UCRP disability benefits (which would instead be provided by a separate – and arguably much less secure – welfare plan.) Moreover, as a new plan, PP1 would require higher relative annual contributions, with correspondingly dimmer prospects for future benefit improvements in the near term.

Second, with respect to the defined contribution pension plans, employee deferral limits under the new 401(k) plan will be half of the combined limits under the UC Section 402 and 457 Plans. Moreover, the investment options under the 401(k) plan will be more restricted, and the administrative expenses charged to participants will be higher, than under the UC defined contribution plans. Finally, health benefits under TCP1 will be likely be more restricted, as vendors will not offer the same contracts to a group with substantially lower enrollment.

In sum, then, current employees are being threatened with loss of employment unless they agree to cease participation in (and relinquishing all vested rights under) the UC Plans and instead participate in benefit plans that are both less secure and inferior in several specific respects. Such an action may constitute a violation of Section 510 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1140, which provides as follows:

It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan [or] this title, ... or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan [or] this title ... ²

In addition, the proposed benefit changes would appear to particularly disadvantage older employees, both because those employees will lose their most valuable (late year) benefit accruals under the UCRP (substituting them for the least valuable early year accruals under PP1,) and because many of those employees opted out of Social Security in the 1970s and will now have to pay Social Security taxes from which they are unlikely to derive any benefit. Thus, the proposed changes may also constitute a violation of the Older Workers Benefit Protection Act of 1990, which amended the Age Discrimination in Employment Act (ADEA, 29 U.S.C. § 621 *et seq.*) by prohibiting age

² The new private sector LANS entity, as well as UC and the other partners participating in it, could be liable under Section 510 and/or related laws.

discrimination with respect to employee benefits as well as with respect to other compensation or terms and conditions of employment.

II. Current Retirees

We understand that UC is spinning off assets and liabilities of current LANL retirees and inactive vested participants into a separate UC-sponsored plan, a decision that we believe is potentially actionable under Article XVI, Section 17 of the California Constitution.

It is likely that the proposed spin-off from UCRP of assets and liabilities of current LANL retirees and inactive vested participants would fail to comport with the Regents' fiduciary duties under Article XVI, Section 17 of the California Constitution, and in particular would violate the "exclusive purpose" rule. The spin-off would appear to be designed solely to benefit UC in its capacity as Plan sponsor, at the expense of certain Plan participants, whose benefits would be provided through a plan with a substantially lower funded ratio.

We are available to discuss these matters with you in greater depth at your convenience.