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November 6, 2000

Retirees Found Varity Untruthful As Firm Sought to Lower Costs

By **ELLEN E. SCHULTZ**

Staff Reporter of THE WALL STREET JOURNAL

Just a week before Christmas in 1986, Jill Wellman, benefits manager at a unit of Varity Corp., wrote a memo about how the company could reduce its retiree health-care costs.

"You have asked that I be inventive in coming up with a solution," she wrote. "As far as I can determine there is only one solution" that doesn't involve the risk of having to pay the benefits in the end, "and that would be the death of all existing retirees and survivors."

'Not Necessarily Legal' Solutions

Her memo, however, went on to suggest "more practical" though "not necessarily legal" solutions to meet the cost-cutting goal sought by Varity, a farm and industrial equipment maker, as well as hundreds of other companies at the time. These included establishing "an offshore company responsible for the retirees but not accountable under United States law and have it go bankrupt and thus terminate the plans." Another option: terminating the benefits, facing "an almost certain class-action suit" and negotiating a settlement pact.

Ms. Wellman's list of possible tactics was just one of numerous compiled by Varity's managers and executives. Obtained by retirees suing the company, but never before made public, the documents are rarely seen blueprints that show how one company, aided by its benefits consultants, plotted to sharply reduce retiree medical coverage to give its balance sheet a boost.

Varity ultimately tried most of the ideas, with mixed results, paralleling cost-cutting moves at many other companies nationwide during the 1980s and 1990s. Among other steps, Varity actually did set up a business unit to fail. The failure was designed to free it of

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health-care coverage of about 4,000 retirees. After the unit's 1988 collapse, some of the 1,500 workers who had transferred to it sued, alleging they had been misled about the security of their benefits, and the U.S. Supreme Court ultimately ruled in their favor, restoring the benefits. Many other retirees were stripped of some of their health-care coverage less drastically, through a strategy the company dubbed "Creeping Take Aways."

Variety merged with Lucas Industries in 1996, and that company was acquired by [TRW](#) Inc. in 1999. "We're simply not in the position to comment on the motivations or decisions made by previous management," a spokesman for TRW says.

Ms. Wellman, now with another employer, says the memo was written in "frustration" after numerous requests from upper management for solutions to the perceived high cost of retiree medical benefits. She stresses that she wasn't recommending any of the steps she outlined. "I was not party to overall corporate strategy," she says.

Few Risks for Company

By the mid-1980s, Variety, like many employers, was eager to reduce the cost of its retiree medical program, and it asked its benefits experts to come up with solutions. Company executives didn't initially think they could unilaterally slash the benefits, as these had been promised to salaried employees and negotiated with unionized ones, who had accepted lower wages in return. "Worse yet, there is language in many of the contracts, booklets, and general descriptive material that implies a lifetime commitment," company documents noted. "We would never" succeed in court.

But the executives quickly figured out that, under federal pension law, there was little risk in trying. If successful, the company would save money; if sued, the worst outcome would be getting stuck with the benefits as promised. There are no punitive damages under the Employee Retirement Income Security Act, a federal pension law known as Erisa.

A December 1986 memo penned by Paul W. Pittman, Variety's benefits manager, outlined strategies for minimizing the chance of lawsuits. Under the heading "Creeping Take Aways," he detailed how the company "would progressively introduce minor reductions and usage controls ... designed to be insufficient to warrant retirees incurring the legal cost and trouble to have the benefits reinstated." Mr. Pittman couldn't be reached for comment.

If the retirees failed to challenge such moderate reductions in court, the company could later deflect legal challenges to deeper cuts by

saying the retirees' prior inaction indicated an acceptance that benefits could be cut, other company documents noted.

ONE COMPANY'S BLUEPRINT

Excerpts from internal documents from Varity Corp. discussing the company's ideas on how to save money on retiree medical benefits.

- The company is not committed to maintenance of a retirees standard of living.
- No approach is too aggressive to consider in approaching the redesign of our retiree benefit programs

From a statement called "Philosophy & Objectives"

- **Take Away or Amendment as a Means of Achieving an Agreed Reduction** There are a number of companies that have initiated take away or reduction actions knowing that they would lose at court if challenged. The aim has been to put temporary financial pressure on retirees to force them to agree to early reinstatement but at reduced level. ...

From a Dec. 16, 1986 memo

- **Terminate all retiree benefit coverage** . This approach would almost ensure a class action suit against the company and would likely result in a negotiated settlement involving lower benefit levels .
- **Establish an offshore company** which is responsible for the retirees but not accountable under U.S. law, have it go bankrupt and thus terminate the plans.

From a confidential memo dated Dec. 19, 1986

And, if sued, Varity had options at hand for holding down costs, Mr. Pittman wrote. Should retirees "pool resources or approach their union to fund their case and take the company to court," the company could drag out the case, which would put "financial pressure" on the retirees "by forcing them to incur their own medical expenses, in addition to funding the legal proceedings. The next step is for the company, at a carefully chosen moment, to suggest to retirees that they agree to reinstatement of the plan, but at a much reduced level."

Mr. Pittman also proffered a suggestion he dubbed "pleading." He said the company could tell retirees "that the burden of medical expenses amongst U.S. retirees is unbearably high and would ultimately cause Varity Corp. to cease trading in the U.S., and that this would necessitate not only a loss of medical benefits, but also possibly the loss of some pension rights as well." Any agreements on this front would help the company establish its right to make even deeper cuts later, other company documents noted.

And like Ms. Wellman's list, Mr. Pittman's included the possible

creation of a unit designed to go belly-up. Termed "Organized Liquidation," he predicted that retirees would sue. But, he wrote, "if made to look realistic, the collapse of [the unit] could be part of a strategy leading to a negotiated reduction" of benefits.

In the next few years, Varity aggressively tried out the memo writers' suggestions, including moving ahead with Massey Combines, the unit that was designed to fail. "Project Sunshine" was the name of the effort to persuade employees to transfer into the unit, assuring them it had a "bright" future. (Interestingly, Ms. Wellman, the 1986 memo writer, worked there when it failed in 1988; she later worked as a human-resources director at another Varity unit.) In addition, the company began its program of "Creeping Take Aways," limiting benefits by such things as a retiree managed-care program and higher co-payments and deductibles.

But savings from these moves weren't considered significant enough, company documents show, which is why in 1992 Varity began planning additional cuts. The eagerness to plow ahead was driven in part by a new accounting rule requiring companies to report the cost of future retiree health-care costs on their financial statements.

In a July 1992 memo, consulting firm Towers Perrin assured Varity that it would send over an expert who has "successfully negotiated rather dramatic decreases in postretirement welfare benefits." Indeed, while the Varity staff was hoping to get a 40% reduction in retiree medical costs, Towers Perrin's model, dubbed Strawman, subsequently projected a 63% reduction in the accumulated liability.

Some of the reduction would be accomplished by changing the assumptions used to calculate Varity's health-care liability. But "the real reduction," Towers Perrin concluded, "can come only if the benefits are reduced."

A spokesman for Towers Perrin says the firm was merely pointing out options, noting that the role of actuaries is to "provide advice on the choices a company faces as well as the consequences of these choices," but that the decisions and consequences are a client's. "Unfortunately, when companies are in financial difficulty, consultants help them find ways to recover, and not everybody can be satisfied," he says.

To aid Varity, Towers Perrin prepared charts showing which units had the highest potential retiree costs. Meanwhile, a "Litigation Risk" analysis prepared by Varity's legal consultants showed which units would be the easiest targets for benefits reductions, thanks to ambiguous wording in labor contracts. "The Company is not committed to maintenance of a retiree's standard of living," noted a memo Varity sent to managers later that year, headed "Philosophy & Objectives."

That memo -- it is unclear who wrote it -- went on to say: "We are not averse to assuming acceptable levels of risk [of lawsuits]. ... No approach is too aggressive to consider." This was followed by another memo -- identified as an "overview statement" by Varsity's then-chief executive officer, Victor Rice -- emphasizing the importance of taking "aggressive actions that would be reviewed favorably within the financial community." The memo added: "Continue to aggressively push legal counsel on risk analysis. ... I don't believe in 'show stoppers,' and won't accept them. Give me a course of action." Mr. Rice couldn't be reached to comment.

In April 1993, the company announced it would significantly reduce benefits. As the company predicted, the retirees sued. At the time, it was also battling *Howe vs. Varsity*, the lawsuit over the failed Massey Combines unit. The Des Moines, Iowa, jury in that case heard testimony from executives about how Mr. Rice, the CEO, had bragged that he had "loaded all his losers in one wagon." It concluded that the workers had been duped and awarded them \$36 million in punitive damages. However, as punitive damages aren't allowed under Erisa, the award was thrown out. In 1996, the Supreme Court upheld the lower court's decision to reinstate the retirees into Varsity's health-care plan -- which Varsity was in the process of cutting.

In 1993 and 1994, union and salaried retirees brought separate suits against different Varsity units over the 1994 cuts, and in 1997 the company agreed to settle the suits, restoring 90% to 100% of the benefits. In one notable retiree victory in 1997, a federal judge in the Eastern District of Michigan granted a motion for summary judgment to retirees at Varsity's Kelsey-Hayes unit, citing "a veritable mountain of evidence" that the company had promised lifetime medical benefits to 3,300 retirees and their spouses.

As it turned out, in none of these cases did the memos play a role. They were discovered too late to pertain to *Howe vs. Varsity*, while the other cases were resolved before the memos became material, says Roger McClow, an attorney in Southfield, Mich., who represented Varsity workers in three of the lawsuits.

After TRW bought the company, the retirees were enrolled in existing TRW retiree medical plans. A TRW spokesman says it believes the arrangement with the retirees has "worked well for both the retirees and the company." TRW's plan documents note that it maintains the right to change the plans at any time.

Write to Ellen E. **Schultz** at ellen.schultz@wsj.com



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