Case No. 05-3588

**UNITED STATES COURT OF APPEALS**
**FOR THE SEVENTH CIRCUIT**

**KATHI COOPER, ET AL.**

**Plaintiffs-Appellees,**

**v.**

**THE IBM PERSONAL PENSION PLAN**
**AND IBM CORPORATION,**

**Defendants-Appellants.**

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Appeal from the Order of the United States District Court for the Southern District of Illinois entered on July 31, 2003, in Civil Action No. 99-829

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**BRIEF *AMICI CURIAE* OF**

**AMERICAN BENEFITS COUNCIL**
**AT&T CORPORATION**
**BP AMERICA INC.**
**ELECTRONIC DATA SYSTEMS CORPORATION**
**EL PASO CORPORATION**
**HONEYWELL INTERNATIONAL INC.**
**MERCER HUMAN RESOURCE CONSULTING, INC.**
**THE ERISA INDUSTRY COMMITTEE**
**WATSON WYATT WORLDWIDE**
**WELLS FARGO & COMPANY**

**IN SUPPORT OF APPELLANTS URGING REVERSAL**

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Date: November 4, 2005

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## CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the following disclosures are made:

1) Davis and Harman LLP (1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004) is the sole law firm appearing for the *Amici*.

2) American Benefits Council (the "Council") and The ERISA Industry Committee ("ERIC") are associations and have no parent corporations. No publicly held corporation owns any part of the Council or ERIC.

3) AT&T Corporation ("AT&T") is a publicly held corporation and does not have a parent corporation as of the date this brief is filed. However, an acquisition by and merger with SBC Communications, Inc. ("SBC") is pending and may be completed within the next 30 days, pending final approval by the states of California and Illinois. Federal approval of such merger has been granted. To the best of our knowledge, no publicly held corporation owns 10 percent or more of AT&T. However, Capital Research and Management Group, an institutional investor, owns approximately 13 percent of the shares of AT&T.

4) BP America Inc. has a parent corporation, BP plc. To the best of our knowledge, no publicly held corporation owns 10 percent or more of BP plc.

5) Electronic Data Systems Corporation ("EDS") does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent or more of EDS.

6) El Paso Corporation does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent or more of El Paso Corporation.

7) Honeywell International Inc. ("Honeywell") does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent or more of Honeywell.

8) Mercer Human Resource Consulting, Inc. is a wholly owned subsidiary of Mercer Human Resource Consulting LLC, which is wholly owned by Mercer Inc. Mercer Inc. is a wholly owned subsidiary of March & McLennan Companies. To the best of our knowledge, no publicly held corporation owns more than 10 percent of Marsh & McLennan Companies.

9) Watson Wyatt Worldwide is a trade name for Watson Wyatt & Company. It is a subsidiary of Watson Wyatt & Company Holdings. To the best of our knowledge, no publicly held corporation owns 10 percent or more of Watson Wyatt & Company Holdings.

10) Wells Fargo & Company does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent of more of Wells Fargo & Company.

11) *Amici* are unaware of any publicly held corporation that is not a party to the proceeding before this Court having a financial interest in the outcome of the proceeding.

12) This is not a bankruptcy appeal.

Kent A. Mason Date

## STATEMENT REGARDING CONSENT TO FILE *AMICI* BRIEF

Counsel for defendants-appellants has consented to the filing of this *amici* brief. Counsel for plaintiffs-appellees has not consented to the filing of this *amici* brief. A motion for leave to file this *amici* brief is filed herewith.

11/4/05

Kent A. Mason Date

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## STATEMENT OF INTEREST

American Benefits Council (the "Council") and The ERISA Industry Committee ("ERIC") are broad-based non-profit organizations dedicated to protecting and fostering privately-sponsored employee benefit plans.

The Council's approximately 250 members include primarily major U.S. employers that provide employee benefits to active and retired workers, and do business in many states. The Council's membership also includes organizations that provide services to employers of all sizes regarding their employee benefit programs. Collectively the Council's members either directly sponsor or provide services to retirement and health benefits plans covering more than 100 million Americans.

ERIC's members represent America's largest private employers and provide benefits to millions of active and retired workers and their families through pension, health care, and other employee benefit plans governed by the Employee Retirement Income Security Act of 1974 ("ERISA"). All of ERIC's members do business in more than one State, and many have employees in all fifty States.

AT&T Corporation, BP America Inc., Electronic Data Systems Corporation, El Paso Corporation, Honeywell International Inc., and Wells Fargo & Company are all national companies that do business in states across the country. Each of

these companies maintains at least one hybrid defined benefit pension plan that would be directly affected by the decision of this Court.

Mercer Human Resource Consulting, Inc. and Watson Wyatt Worldwide are human resources consulting firms that provide services in connection with hybrid defined benefit plans. As service providers, these companies have a wealth of experience and expertise with hybrid pension plans.

In cases of exceptional importance, with the potential for far-reaching effects on employee benefit plans, the Council and ERIC have participated together and separately as *amicus curiae.* [1] Both the Council and ERIC base the decision to file an *amicus* brief on criteria that limit participation to significant cases in which the Council and/or ERIC believe their discussion of the issue will advance arguments that will not be presented by the parties or by other *amici*. This case has been identified as one raising an issue of critical importance because of its potential impact on the defined benefit pension system.[2]

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[1] *See, e.g.*, *General Dynamics Land Sys. v. Cline*, 540 U.S. 581 (2004); *Black & Decker Disability Plan v. Nord*, 538 U.S. 822 (2003); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996); *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989); *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58 (1987).

[2] While IBM is a member of the Council and ERIC and serves on the boards of directors of both organizations, IBM did not participate in either organization's decision-making process for determining whether to file this brief. (For the Council, IBM is one of 15 members on the board's executive committee; for ERIC, IBM is one of 25 on the board.)

Individual companies rarely file *amicus* briefs in these types of cases. However, the dramatic effects an adverse decision would have for these companies' employees and their businesses have compelled them to take the extraordinary step of filing an *amici* brief.

The district court's decision suggests that virtually all hybrid defined benefit plans and many other common defined benefit plan designs are unlawful. If affirmed, the cost to American businesses will almost certainly run well over $100 billion and there is little doubt that many companies will exit the voluntary employer-maintained defined benefit system through plan freezes and terminations, leaving millions of workers with diminished retirement security. As a result, the Council, ERIC, and the companies have filed this *amici* brief to urge the Court to reverse the district court's decision.

The Council, ERIC, and the companies are committed to a vital and sustainable defined benefit pension system. Defined benefit plans help millions of Americans achieve retirement security by providing employer-funded retirement income. In the private sector, employees are not typically required to make any contributions toward their benefits in these plans and the assets in defined benefit plans are managed by investment professionals. Employers, rather than employees, bear the investment risk of ensuring that plan assets are sufficient to pay promised benefits. In addition, insurance from the Pension Benefit Guaranty

Corporation ("PBGC") means employees' retirement benefits are largely guaranteed.

As of 2000 (the most recent year for which official Department of Labor statistics have been published), more than 19 million retirees were receiving benefits from defined benefit plans, with over $120 billion in benefits paid out in that year alone.[3] Given that America's personal savings rate remains one of the lowest among industrialized nations[4] and that average balances in 401(k) plans are quite modest,[5] there is no doubt that in the absence of defined benefit pensions fewer Americans would be financially prepared for retirement. Furthermore, the absence of defined benefit pensions would result in increased strain on federal entitlement and income support programs, not to mention an increase in the number of American seniors living in poverty.

Given these statistics, the value of defined benefit plans to many American families is undeniable. Yet our nation has seen an alarming decline in defined

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[3] U.S. Census Bureau, Statistical Abstract of the United States: 2004-5, Chart No. 532 (Source: U.S. Department of Labor, Pension and Welfare Benefits Administration, *Private Pension Plan Bulletin*, winter 2003, and unpublished data).

[4] The Organization for Economic Cooperation and Development, Main Economic Indicators (Paris: OECD, January 2004).

[5] In fact, data from the Employee Benefit Research Institute shows that in 2002 the average 401(k) account balance for workers age 21 to 64 was only $33,647 and the median (mid-point) 401(k) account balance was a mere $14,000. EBRI Notes, Vol. 26 No. 1 (January 2005).

benefit plan sponsorship and today is a particularly precarious time for the defined benefit system. Employers are increasingly exiting the system.[6] The total number of PBGC-insured defined benefit plans has decreased from a high of more than 114,000 in 1985 to fewer than 32,000 in 2004.[7] This downward trend is even more sobering if you look solely at the past several years. Not taking into account pension plan freezes (which are also on the rise but not officially tracked by the government),[8] the PBGC reported that the number of defined benefit plans it insures has decreased by 8,000 (or 21%) in just the last five years.[9]

The sole bright spot on the defined benefit landscape has been the hybrid plan. Hybrid plans are defined benefit pensions that incorporate attractive features of defined contribution plans. The most popular hybrid plans are the "cash balance" design and the "pension equity" design. In a cash balance plan, employers provide annual "pay credits" to an employee's notional account and "interest credits" on the balance in the account. In a pension equity plan,

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[6] Last year, the Council released a white paper discussing in detail the multiple threats to the defined benefit system. *See Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System* (May 2004).

[7] Pension Benefit Guaranty Corp., *Pension Insurance Data Book 2004*, at 4 (2005).

[8] A plan freeze typically means closing the plan to new hires and/or ceasing future accruals for current participants.

[9] PBGC *Pension Insurance Data Book 2004*, *supra* note 7, at 56 & 87.

employers provide credits for each year of service and these credits are multiplied by an employee's final pay to produce a lump sum figure. Hybrid plans offer the security of a traditional defined benefit plan through employer funding, employer assumption of investment risk, professional investment management, federal guarantees and required lifetime and spousal benefit options; they also show account balances in a lump sum format, are portable, and provide for a benefit accrual pattern that is more even across a worker's entire career than traditional defined benefit plans.

The positive characteristics of hybrid plans have driven their explosive growth since the cash balance plan first became known by that name in 1985.[10] Nearly one-third of large employers have converted their traditional plans to cash balance or pension equity plans.[11] Under one method of conversion, affected employees are entitled to the sum of their accrued benefit under the traditional formula, which is frozen as of the date of conversion, plus their accrued benefit under a new cash balance arrangement. Under another common method of conversion, accruals under the traditional formula are frozen and an opening account balance is set. This "conversion" to an opening account balance is

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[10] *See, e.g.*, Leonard Sloane, *Your Money; Cash Balance Pension Plans*, N.Y. Times, section 1, page 36, column 1 (Aug. 17, 1985).

[11] PBGC *Pension Insurance Data Book 2004*, *supra* note 7, at 59-60.

typically accomplished using the present value of the frozen accrued benefit, applying interest and mortality assumptions. It is not at all uncommon to provide an even higher opening account balance if an employee would have had a larger account if the cash balance formula had always been in effect; IBM's "Always Cash Balance Formula" is an example of this approach.[12]

As of the year 2003 (the most recent year for which official government data is available), almost 25 percent of all private single-employer defined benefit plan participants were covered by hybrid plans.[13] According to the PBGC, there were more than 1,500 of these plans providing benefits to more than 8 million Americans as of 2003.[14] This represents a nearly 25 percent increase in the number of plans, as well as an increase of more than one million hybrid plan participants since 2001.[15] Moreover, there is every reason to believe this trend would be even more pronounced but for the district court's ruling in 2003.

If affirmed, the district court's decision would be devastating for our private pension system. In addition to the cost to American business and the effect of the

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[12] It is even more common for pension equity plans to provide for an initial benefit upon conversion based on the benefit participants would have had if the pension equity plan had always been in effect.

[13] PBGC *Pension Insurance Data Book 2004, supra* note 7, at 59-60.

[14] *Id.*

[15] *Id.*

inevitable plan freezes and terminations on plan participants, the increased plan liability would overload the already strained PBGC, which insures defined benefit plans. Moreover, many companies would be left without a viable defined benefit plan design option. Traditional defined benefit plans, which typically provide an annuity benefit that is a multiple of years of service and final salary, no longer make sense for many employers. In many industries, only a fraction of the workforce ever earns a meaningful retirement benefit under a traditional plan because these plans provide the bulk of their benefits to long-service employees. In these industries, hybrid plans are the only viable defined benefit plan design option and the affirmance of the district court's decision would signal the end of a significant segment of the defined benefit plan system. Taken as a whole, affirmance of the district court's opinion would be one of the most adverse developments in the history of the voluntary-employer maintained defined benefit system, if not the most adverse, and we urge this Court to reverse.

## ARGUMENT

The sole issue addressed in this *amicus* brief is whether cash balance plan[16] designs are inherently age discriminatory under section 204(b)(1)(H) of ERISA, which states:

> [A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.

Substantially identical provisions appear in the Age Discrimination in Employment Act of 1967 ("ADEA") and the Internal Revenue Code of 1986 (the "Code"). Congress enacted the three provisions as part of the Omnibus Reconciliation Act of 1986 ("OBRA") and intended that they be interpreted in a consistent manner. *See* H.R. Conf. Rep. No. 99-1012, at 378-79 (1986).

The district court interpreted this rule to mean that the amount of the benefit earned as of normal retirement age cannot be less for an older worker than a younger worker. This interpretation means that any pension plan that provides benefits of <u>equal present value</u> to participants of different ages will be age discriminatory because younger workers have a longer period to reap the advantages of compound interest, thereby receiving a larger benefit at retirement

[16] The issue on appeal is whether the IBM Personal Pension Plan's cash balance formula is age discriminatory and this brief focuses on cash balance formulas. However, the district court's theory raises similar issues for other hybrid designs, particularly pension equity plan designs.

for that year's contribution. Under this interpretation, for example, a cash balance plan that credits all employees with 5 percent pay credits and equal interest credits would be age discriminatory, even though all employees are treated the same regardless of age. In fact, plans that provide greater pay credits to older participants would generally still be considered age discriminatory under this interpretation. We urge the Court to reject this artificial and strained reading of section 204(b)(1)(H), which overlooks the purpose and structure of the statute, the time value of money, and the impact this reading would have on many common defined benefit plan designs and our pension system as a whole.

## I. CASH BALANCE PLANS ARE NOT INHERENTLY AGE DISCRIMINATORY.

### A. The District Court's decision is contrary to the overwhelming weight of authority, the statutory language, and the legislative history.

Since cash balance plans first became publicly known by that name in 1985, such plans have been repeatedly recognized as valid, non-age discriminatory plans by the courts and by the Treasury Department.

Every other court that has addressed the issue has concluded that there is nothing inherently age discriminatory about cash balance plan designs. *See Eaton v. Onan Corp.*, 117 F. Supp. 2d 812, 822-834 (S.D. Ind. 2000) (ERISA section 204(b)(1)(H) does not apply to accruals prior to normal retirement age; even if it did, cash balance plans do not inherently violate its requirements); *Tootle v.*

*ARINC, Inc.*, 222 F.R.D. 88 (D. Md. 2004) (same conclusions as *Eaton*); *Engers v. AT&T Corp.*, No. 98-3660, 2001 U.S. Dist. LEXIS 25889 (D. N.J. June 6, 2001) (ERISA section 204(b)(1)(H) does not apply to accruals prior to normal retirement age); *see also Campbell v. BankBoston, N.A.*, 327 F.3d 1, 10 (1st Cir. 2003) (in dictum, the court states (1) "the ERISA age discrimination provision may not even apply to workers younger than the age of normal retirement", and (2) "it is by no means clear that the annuity method is the only permitted method" of testing for age discrimination under ERISA). Further, in a strongly analogous circumstance, the Seventh Circuit held that a defined benefit plan complies with section 204(b)(1)(H) if it treats employees "in exactly the same way" at all ages. *Lunn v. Montgomery Ward*, 166 F.3d 880, 883 (7th Cir. 1999).

Moreover, until 1999, the Internal Revenue Service ("IRS") consistently granted favorable determination letters with respect to cash balance plans, approving them as satisfying the tax-qualification requirements (including the Internal Revenue Code counterpart of section 204(b)(1)(H)). The moratorium on IRS determination letters that began September 15, 1999 only applied to conversions to cash balance plans, and thus was clearly not focused on the inherent design of cash balance plans. *See* Carol Gold, IRS Internal Memorandum on Pension Plan Conversions to Cash Balance Plans (Sept. 15, 1999). Further, in 1999, IRS Chief Counsel Stuart Brown testified that interest credits under a cash

balance plan do not cause the plan to violate the Internal Revenue Code counterpart to section 204(b)(1)(H). *See* Stuart L. Brown, Chief Counsel for the Internal Revenue Service, Testimony before the Senate Committee on Health, Education, Labor and Pensions, 1999 TNT 183-11 (Sept. 21, 1999).

The Treasury Department has also issued guidance addressing how various rules apply to cash balance plans, which would make little sense if cash balance plans were inherently age discriminatory. *See, e.g.,* Treas. Reg. § 1.401(a)(4)-8(c)(3), 26 C.F.R. § 1.401(a)(4)-8(c)(3); IRS Notice 96-8, 1996-1 C.B. 359 (Feb. 5, 1996). In fact, the Treasury Department explicitly rejected the argument that cash balance plans fail to satisfy the Internal Revenue Code counterpart to section 204(b)(1)(H) in the preamble to 1991 regulations. 56 Fed. Reg. 47524, 47528 (Sept. 19, 1991). While the Treasury Department has withdrawn proposed regulations that would have squarely recognized the validity of cash balance plans, that withdrawal did not reflect a finding that hybrid plans are age discriminatory, but rather was intended "to provide Congress an opportunity to review and consider a legislative proposal on cash balance plans...." Department of Treasury Press Release, Treasury and IRS Withdraw Proposed Cash Balance Regulations (June 15, 2004); *see also* IRS Announcement 2004-57, 2004-27 I.R.B. 15 (July 6, 2004). The Treasury Department's entirely rational construction of the statute

should be given considerable deference. *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984).

Moreover, the language of section 204(b)(1)(H) and its legislative history indicate that cash balance plans do not violate the age discrimination rules. First, the legislative history strongly indicates that the age discrimination provisions only apply after a participant attains normal retirement age.[17] Even if section 204(b)(1)(H) is interpreted to apply to accruals prior to normal retirement age, the "rate of an employee's benefit accrual" (the phrase used therein) should not be determined by reference to the employee's annual benefit commencing at normal retirement age. If Congress had meant for section 204(b)(1)(H) to be interpreted in that manner, Congress could easily have used any of several defined terms that appear elsewhere in section 204(b). For example, Congress could have referred to

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[17] *See* H.R. CONF. REP. NO. 99-1012, at 376 (1986) (hereinafter "Conference Report") ("The Senate Amendment [which the Conference Report generally follows] amends ADEA, ERISA, and the Code to require a plan to provide for benefit accruals and contributions with respect to an employee's years of plan participation after normal retirement age."); *see also* heading of Code section 411(b)(1)(H): "Continued Accrual Beyond Normal Retirement Age." All courts that have addressed the issue have interpreted section 204(b)(1)(H) in this manner. *See Eaton*, 117 F. Supp. 2d 812; *Tootle*, 222 F.R.D. 88; *Engers*, No. 98-3660; *see also Campbell,* 327 F.3d at 10 (in dictum, court states that "the ERISA age discrimination provision may not even apply to workers younger than the age of normal retirement"); 53 Fed. Reg. 11,876 (Apr. 11, 1988) (preamble to first proposed regulations under the Internal Revenue Code counterpart of section 204(b)(1)(H) states: "This document contains proposed regulations relating to the requirement for continued accruals beyond normal retirement age under employee pension benefit plans.").

an employee's "normal retirement benefit" (used, for instance, in section 204(b)(1)(A)), the "annual rate at which any individual . . . can accrue the retirement benefits payable at normal retirement age" (the words in section 204(b)(1)(B)) or the "annual benefit commencing at normal retirement age" (used in section 204(b)(1)(C)). Similarly, section 204(b)(1)(H)(i) could have been drafted in a manner consistent with section 204(b)(1)(B) to read as follows:

> Notwithstanding the preceding paragraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, *the rate at which an employee accrues the retirement benefit payable at normal retirement age (or the employee's age if later) is ceased, or such rate is reduced*, because of the attainment of any age. [changed portion in italics]

By purposely not using such other terms and instead using a phrase not defined in the statute or regulations, Congress was leaving but one place to look for the meaning of the phrase, *i.e.,* the plan documents themselves. Indeed, section 204(b)(1)(H) specifically states that a defined benefit plan fails to satisfy section 204 only "if, *under the plan*, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age" (emphasis added). Thus, the determination of whether a plan satisfies section 204(b)(1)(H) should be based on whether the plan's benefit formula reduces or ceases pay credits (or interest credits) because of the attainment of any age. This is the result under the well-reasoned decisions in *Eaton* and *Tootle. See Eaton*, 117 F. Supp. 2d at 832-33; *Tootle*, 222 F.R.D. at 93-94. Cash balance plans would

clearly satisfy section 204(b)(1)(H) based on the benefit formulas as set forth in the plan documents; this is so because the contribution credits under the benefit formulas either are provided on an age-neutral basis or actually increase with increased age and/or service.[18]

Therefore, the district court's decision, holding that hybrid plan designs are inherently age discriminatory, is contrary, not only to the weight of authority, but also to the statutory language and the clear intent of Congress.

### B. Any other interpretation would cast doubt on common pension plan designs that Congress was aware of when it adopted section 204(b)(1)(H).

In the context of age discrimination, it makes little sense to compare the age 65 benefit accrual of a 25-year old with the age 65 benefit accrual of a 64-year old, as the district court did. The 64-year old will receive his or her benefit much sooner and will only have one year as opposed to 40 years to accrue interest (i.e., the "time value" of money must be taken into account). The district court itself acknowledged the strength of this argument, stating, "From an economist's perspective, Defendants have a good argument." Nonetheless, the district court

[18] Even assuming *arguendo* that section 204(b)(1)(H) requires normalizing benefits as of normal retirement age, it does not follow that projected interest credits should be taken into account for this purpose. Projected interest credits are taken into account under the Internal Revenue Code's backloading rules, but these rules reflect an entirely different statutory purpose and there is no reason to believe that this approach is required under section 204(b)(1)(H). *See* Notice 96-8 (discussing the backloading rules in the context of cash balance plans).

went on to conclude incorrectly that the age discrimination laws require rejection of basic economic principles.

Not only is the district court's view wrong as a matter of law and a matter of economics, the district court fails to recognize or acknowledge that if its view on this subject is correct, then a broad range of pension designs viewed as perfectly appropriate under the pension age discrimination prohibition Congress adopted in 1986 would be considered age discriminatory.

For example, if the "rate of an employee's benefit accrual" were to be based on the annual benefit payable at normal retirement age, all or substantially all contributory defined benefit plans would be disqualified. Contributory defined plans are defined benefit plans under which an employee's benefits are conditioned in whole or in part on the employee making certain specified contributions to the plan. The employee contributions required under such a plan must be credited with interest under ERISA section 204(c), 29 U.S.C. § 1054(c), and provide a minimum benefit at normal retirement age. As a result, the portion of the plan attributable to these contributions closely resembles a cash balance plan in their benefit accrual pattern. In 1986, Congress clearly did not intend to prohibit contributory defined benefit plans, a common type of arrangement both then and now, among State and local governments (which are subject to section 4(i) of the

Age Discrimination in Employment Act of 1967 ("ADEA"), 29 U.S.C. § 623(i), the ADEA counterpart to ERISA section 204(b)(1)(H)).

Similarly, any pension plan that provides for pre-retirement indexing of benefits would be considered age discriminatory under the district court's theory. For example, a variable annuity plan that increases benefits based on asset returns would be impermissible because younger participants would have more years until normal retirement age to reap the benefits of market rates of return. By way of another example, career average pay plans that provide for pre-retirement indexing would also be unlawful. In these plans, accrued benefits are increased based on changes in an index, such as one based on consumer prices or wage increases. However, under the district court's theory, the mere fact that younger workers would have more years until normal retirement age to benefit from the indexing would cause these plans to be inherently age discriminatory.

Not only would the district court's theory indicate that many common plan designs are unlawful, it would even outlaw the sole example of a compliant plan cited in the legislative history to section 204(b)(1)(H). *See* Conference Report at 381 (example illustrating interaction of section 204(b)(1)(H) and suspension of benefits rules in section 203(a)(3)). Like most traditional defined benefit plans, the plan illustrated in the Conference Report provides an annuity that increases at the same rate with each year of service before and after normal retirement age. Any

plan that shares this commonplace pattern of benefit accruals would be age discriminatory under the district court's theory, which requires normalizing the rate of accrual as of normal retirement age. As a result, the normal retirement age benefit accrual of a 70-year old would be less than the normal retirement age benefit accrual of a 67-year old because the 70-year old's benefit would be discounted over 5 years (assuming an age 65 normal retirement age) while the 67-year old's benefit would be discounted over 2 years. This is simply the mirror of the district court's approach of normalizing accruals at age 65 for participants who are younger than age 65.[19] The district court's approach makes little sense for employees working before normal retirement age and makes even less sense for employees working past normal retirement age -- the intended beneficiaries of the legislation.

Ironically, although not technically subject to section 204(b)(1)(H), the district court's analysis would even mean that the U.S. social security system, which provides for pre-retirement indexing, is age discriminatory.[20]

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[19] The example in the legislative history illustrates the interaction of section 204(b)(1)(H) and the suspension of benefits rules in section 203(a)(3). The declining value of post-normal retirement age accruals in the example is not caused by the suspension of benefits rules. Those rules impact the value of previously accrued benefits, not the value of new accruals.

[20] 42 U.S.C. § 415(a)(1)(B) (indexing Social Security old-age retirement benefits for increases in average national wages before retirement age.)

### C. Adoption of the district court's theory would have staggering financial consequences that Congress could not possibly have intended.

The district court's theory would likely outlaw "hundreds of cash balance plans with millions of participants" nationwide. *Eaton*, 117 F. Supp. 2d at 823. In this regard, adoption of the district court's theory would contradict the Supreme Court's command that ERISA should not be interpreted to impose burdens that unduly discourage employers from offering benefit plans in the first place. *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996). The district court's interpretation of section 204(b)(1)(H) should therefore be rejected, as "[s]tatutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." *American Tobacco Co. v. Patterson*, 456 U.S. 63, 71 (1982). Especially in the ERISA context, the Supreme Court has rejected statutory interpretations that would lead to "improbable results," such as the invalidation of procedures "that no one would think violate" ERISA. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 81 (1995).

There are no firm numbers on the cost to American businesses if the district court's theory is accepted as law but it is safe to say that, at a minimum, the cost would be well over $100 billion. In the instant case, the Plaintiffs-Appellees' proposed remedy at the district court level would have increased the IBM Personal Pension Plan's liability by approximately $5.7 billion, and would have increased

the total liability for all active participants by 40%.[21] Applied to cash balance and pension equity plans across the country, the immediate increase in pension liabilities that would have resulted from applying Plaintiffs' proposed remedy to other cash balance and pension equity plans would have been well over $100 billion, and perhaps far in excess of that sum.[22]

These increased liabilities would have far-reaching effects. First, almost any employer with a cash balance or pension equity plan would have little choice but to completely "freeze" its plan (so that prospectively, no employees would earn any additional benefits) so as to avoid increasing an unmanageable liability any further. Few employers could afford to continue to provide benefits after absorbing anything remotely close to a 40% increase in liabilities. This could mean that well over eight million participants would lose all further benefits. This may not be meaningful for the 64-year old who would receive an enormous windfall. However, it would be devastating for all younger generations who would see their benefit program collapse.

Moreover, an increase in active participant liability of anything close to 40% would mean total liability increases of at least hundreds of millions of dollars (and billions in many cases) for many, many companies. That type of additional

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[21] Amoroso Report at 12.

[22] *Id.* at 12-15.

liability would preclude companies from investing in their business. It would also force some companies to trim compensation in other areas. In an increasingly competitive business landscape, it is inevitable that the costs associated with an adverse decision would not be borne solely by companies but would instead be shared by employees in the form of reduced total compensation. This could easily take the form of curtailments of other benefits (*e.g.*, 401(k) plan contributions), reduced wage growth rates, or even diminished wages.

The additional liability would also drive numerous companies into bankruptcy, including many non-profit organizations whose communities would suffer accordingly. For example, the Young Women's Christian Association (the "YWCA") maintains a cash balance plan to provide retirement benefits for employees of the 300 community-based YWCAs nationwide that make up the national YWCA. The YWCA (which is referred to as the "Fund") has publicly described the effect of a finding of age discrimination:

> The Fund's liabilities would more than triple and the Fund would become underfunded by approximately $900 million to $1.2 billion. The potential liability is enormous if calculated retroactively, because the Fund, which was established in 1925, has always been a cash balance plan. . . . [U]nder ERISA each YWCA would be jointly and separately liable for all required contributions. No YWCA would have the resources to satisfy the increased obligations. As a result, all or almost all YWCAs would be forced to seek bankruptcy protection and end their charitable services to the communities that they have served

for nearly 150 years. This would mean the end of an American institution.[23]

Moreover, as companies are driven into bankruptcy, their plans are often transferred to the Pension Benefit Guaranty Corporation ("PBGC"). The PBGC is a self-funded governmental organization that insures benefits payable under defined benefit plans. If a plan terminates with insufficient assets, the PBGC is required to provide participants with benefits up to a guaranteed level. The PBGC is entitled to recoup its payments from the plan sponsor, but in the case of a bankrupt employer, this right may not have substantial value. The PBGC is already reporting a large deficit.[24] If the District Court's decision is upheld, the PBGC would inherit a large number of additional plans with enormous unfunded liabilities.

In short, Congress could not have intended these results and, consistent with the principle that statutes should be interpreted to avoid unreasonable results, the district court's opinion should be reversed.

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[23] Brief for the Young Women's Christian Association Retirement Fund, Inc. as Amici Curiae, Hirt v. The Equitable Retirement Plan for Employees, Managers and Agents, (SDNY 2004) (No. 1:01-cv-07920-AKH).

[24] Pension Benefit Guaranty Corp., *2004 Annual Report* at 2 (2004) (reporting a $23 billion deficit, up from $11 billion in the prior year).

## II. CASH BALANCE PLANS REPRESENT SOUND RETIREMENT POLICY.

For all the questions of technical statutory interpretation that this case raises, we should not lose sight of the fact that cash balance plans are fundamentally good plan designs. If policymakers were today working from a clean slate to produce the ideal retirement plan, it is a hybrid plan that they would likely develop.

Employers like hybrid plans primarily because the benefits in the plans are tangible to employees, resulting in greater appreciation of the pension program. Employees are more comfortable with a plan that expresses its benefit as an account balance, rather than a plan that expresses its benefit as a life annuity. Pension benefits expressed as future annuities are difficult for workers to understand because their value depends on interest rates and anticipated mortality and, for many workers, represent an ephemeral benefit far into the future that they do not relate to. The average worker who is age 55 simply cannot determine the value of a single life annuity of $10,000 per year commencing at age 65. Is it worth $50,000 at age 55? Less? Even individuals with financial sophistication may find this valuation difficult. In fact, a survey found that the dominant motives for employer conversions to hybrid plans were employee appreciation of the plan,

facilitating communication with employees, and the ability to show the benefit amount in a lump sum format.[25]

Employees likewise appreciate hybrid plans because they are more transparent and more portable while also retaining the favorable security features of the defined benefit system.[26] The unique value of hybrid plans in meeting employee retirement plan preferences is demonstrated in a recent survey. The survey reveals that workers prefer two retirement plan attributes above all others – the portability of benefits and benefit guarantees.[27] It is only hybrid plans that can deliver both these advantages. Traditional defined benefit plans typically do not

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[25] Sylvester J. Schieber, et al., Watson Wyatt Worldwide, *The Unfolding of a Predictable Surprise: A Comprehensive Analysis of the Shift from Traditional Pensions to Hybrid Plans*, at 44 (February 2000) (96% of respondents indicated employees' appreciation of the plan was either very important or important in the decision to convert to a hybrid plan; 93% of respondents indicated facilitation of communication and the ability to show the benefit amount in a lump sum format were either very important or important in the decision to convert to a hybrid plan).

[26] Julia Lynn Coronado and Phillip C. Copeland, *Cash Balance Pension Plan Conversions and the New Economy*, The Federal Reserve Board: Finance and Economics Discussion Series 2003-63, at 4-5 (Nov. 2003) ("[R]easons that workers may want pensions include the desire to earn tax-favored returns, or to realize economies of scale on the transaction costs of investment, although both of these goals can be realized in a [defined contribution] plan as well as a [defined benefit] plan. In a [defined benefit] plan workers may also realize the opportunity to insure to some degree against mortality, inflation, macroeconomic, and disability risks through inter- and intra-generational risk sharing.").

[27] Watson Wyatt Worldwide, *Hybrid Pension Conversions Post-1999: Meeting the Needs of a Mobile Workforce,* at 6 (2004).

provide for portability, and benefits in 401(k) and other defined contribution plans are not guaranteed. Clearly, preserving hybrid plans as a viable pension design is critical if employers are to maintain retirement programs that meet employee needs and preferences.

Perhaps most important of all, many participants build higher retirement benefits under a hybrid plan than a traditional plan of equal cost.[28] This is because traditional defined benefit plans tend to award disproportionate benefits (often as much as 75% of total benefits under the plan) to very long service employees at the end of their careers. But workforce patterns have changed substantially since traditional defined benefit plans were originally established. It is comparatively unusual for an employee to spend an entire career with a single employer.[29] Hybrid plans were designed to respond to this reality and deliver benefits more equitably to short, medium and longer-service employees than traditional pensions. The advantage of hybrid plans for most workers is confirmed by a recent study that

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[28] Kopp and Scher, *A Benefit Value Comparison of a Cash Balance Plan with a Traditional Average Pay Defined Benefit Plan*, Society of Actuaries, The Pension Forum (Oct. 1998); *see also* Schieber, *supra* note 24, at 24-25 (indicating that about 80% of workers hired at age 30 will no longer be with the employer at age 55).

[29] Watson Wyatt Worldwide 2004, *supra* note 26, at 6 -7; see also Olivia S. Mitchell & Janemarie Mulvey, *Possible Implications of Mandating Choice in Corporate Defined Benefit Plans*, Pension Research Council, (PRC WP 2003-25) (review of 65 large companies "confirms that only 7 percent of workers stay with one employer for their entire careers").

shows that if an employee changes jobs just three times in the course of her or his career, she or he can expect to receive 17% more in retirement benefits from participating in cash balance plans than had her or his employers provided traditional plans.[30]

This is particularly important for demographic groups that tend to experience a greater number of job changes during their working careers. In this regard, hybrid plans tend to be significantly better than traditional plans for women who, despite their changing role in the workforce, continue to experience greater job turnover than men do. One study by the Society of Actuaries found that more than 75 percent of women do better under a cash balance plan than a traditional plan.[31]

More generally, cash balance plans provide a level benefit accrual pattern that stands in contrast to the accrual patterns in many traditional defined benefit plans. Traditional plans often include subsidized early retirement benefits for

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[30] Watson Wyatt Worldwide 2004, *supra* note 26, at 7. The Federal Reserve has likewise reported that "conversions have generally been undertaken in competitive industries that are characterized by tight and highly mobile labor markets. Since mobile workers benefit most from such conversions, we conclude that this trend may have positive implications for the eventual retirement wealth of participants." Coronado and Copeland, *supra* note 25, at 3.

[31] Kopp and Scher, *supra* note 28; *see also* Nancy M. Pfotenhauer, President of the Independent Women's Forum, *Examining Cash Balance Pension Plans: Separating Myth from Fact*, Testimony before the U.S. House Committee on Education and Workforce, 108th Cong. (July 7, 2004).

long-service employees who satisfy certain age and service conditions, *e.g.*, age 55 with 20 years of service. These subsidies can mean that the economic value of an employee's benefit doubles or even triples once the employee reaches early retirement age. The downside to these subsidies is that employees who otherwise qualify for early retirement benefits but choose to continue working stand to suffer a significant economic loss. In many cases, it may be years before an individual who works past early retirement earns any additional benefits on an economic basis. To the contrary, cash balance plans provide level benefit accruals to all employees regardless of age or service.

Traditional plans also often suspend benefit payments for employees who work past normal retirement age.[32] As a result, a worker who remains on the job past a traditional plan's normal retirement age foregoes payments for the period of continuing employment. These foregone payments offset the additional benefits that accrue from continuing to work. The net effect is that the value of a traditional plan generally falls steeply after attainment of the plan's normal retirement age.

In contrast, cash balance plans almost invariably provide pay credits as well as interest credits after both normal retirement age so that the value of the plan is

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[32] *See* ERISA §§ 203(a)(3)(B); 204(b)(1)(H); *see also* 67 Fed. Reg. 76123 (Dec. 11, 2002) (discussing interaction of permitted forfeiture rule and requirement that accruals continue past normal retirement age).

retained whether or not an employee remains on the job after a specified age.[33] As a result, cash balance plans do not discourage workers from remaining on the job at older ages. In this regard, employers like cash balance plans in part because they are better able to retain older workers. Correspondingly, older workers value the opportunity to continue working past traditional retirement ages while still retaining the value of their pension benefits.

In short, it is clear that cash balance and other hybrid plans should continue to be a key component of our national retirement savings system. They are good retirement plans. The district court's decision, however, takes a strained and artificial reading of section 204(b)(1)(H) to conclude that cash balance plans are inherently age discriminatory. The court recognizes that these plans provide all employees with a benefit accrual with the same present value but reads into the statute a requirement that benefit accruals be measured on an arbitrary projected basis by reference to normal retirement age. This interpretation is contrary to the statutory language, the legislative history, long-standing agency interpretations, all of the other courts that have addressed the issue, and common sense. It would

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[33] *See* Richard W. Johnson & Eugene Steuerle, *Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population*, Pension Research Council, (PRC WP 2003-26) (concluding that the growing popularity of hybrid pension plans represents a response to the changing demographics of the labor force, including the need to retain older workers as employers confront labor shortages).

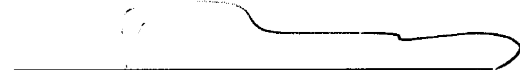
have a devastating effect on employers, employees, the PBGC, and the voluntary employer-maintained defined benefit system.

## **CONCLUSION**

For the reasons stated above, *Amici* respectfully submit that this Court should reverse the judgment of the district court.

Dated: November 4, 2005

Respectfully submitted,



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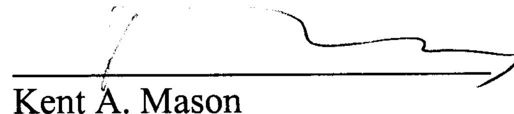
1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,865 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman font.

Dated: November 4, 2005



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**CERTIFICATE OF SERVICE**

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# APPENDIX A

# IRS Memorandum to EP/EO Division Chiefs
# From Carol Gold, Dir. of IRS to EP/EO Div. Chiefs
# September 15, 1999

**INTERNAL REVENUE SERVICE**
***memorandum***

**DATE** September 15, 1999

**TO** EP/EO Division Chiefs

**FROM** Director, Employee Plans Division OP:E:EP
/s/ Carol Gold

**SUBJECT** Conversions to Cash Balance Plans

A number of important issues may be raised when a plan is amended to convert a traditional defined benefit plan formula into a benefit formula commonly known as a "cash balance" formula. This memorandum instructs you to request technical advice before closing any determination or examination case involving such a plan amendment to convert. For this purpose, a "cash balance" formula is a benefit formula in a defined benefit plan by whatever name (e.g., personal account plan, pension equity plan, life cycle plan, cash account plan, etc.) that, rather than expressing the accrued benefit as a life annuity commencing at normal retirement age, defines benefits for each employee by reference to a single-sum distribution amount, such as 10 percent of final average pay times years of service, or the amount of the employee's hypothetical account balance. An employee's hypothetical account balance is typically credited with hypothetical contributions and hypothetical earnings. These hypothetical contributions and earnings are designed to mimic the allocations of actual contributions and actual earnings to an employee's account that would occur under a defined contribution plan. Notice 96-8, 1996-1 C.B. 359, provides a general description of those cash balance plans that define an employee's hypothetical account.

Please identify any open determination or examination cases for defined benefit plans with plan amendments to convert as described above and review them for all issues as usual, including the conversion. Then request technical advice for these plans using current procedures. However, in lieu of the statement of issues, facts, law and arguments with respect to the conversion, you may substitute a statement that technical advice is requested on the effect on the plan's qualified status of the conversion of a traditional defined benefit plan formula to a cash balance formula. Continue this procedure until further notice.

If you have any questions, call me at (202) 622-8300 or a member of your staff may call Mark O'Donnell at (202) 622-7358.