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Pension Law: Cash Balance Pension Plans Are Not Inherently Age Discriminatory: *Cooper v. IBM Personal Pension Plan* Defies a Strong History of Support for the Cash Balance Design

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Pension Law: Cash Balance Pension Plans Are Not Inherently Age Discriminatory: *Cooper v. IBM Personal Pension Plan* Defies a Strong History of Support for the Cash Balance Design*

I. Introduction

In 1985, Bank of America implemented the first cash balance pension plan.[1] Over the next eighteen years, numerous companies converted their traditional defined benefit plans into cash balance pension plans and other hybrid defined benefit plans.[2] Employers have converted their traditional defined benefit plans into cash balance pension plans for a variety of sound reasons; the terms of cash balance pension plans are easier to understand than traditional defined benefit plans, and by providing benefits that accrue more evenly over employees' careers, such plans allow employees greater mobility and flexibility in employment by making it easier to change jobs mid-career.[3] Nevertheless, cash balance pension plans have also received substantial criticism because the conversion from traditional defined benefit plans to cash balance pension plans often decreases older employees' expected future benefits.[4]

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* Winner, 2003-2004 Sharp Award for Outstanding Case Note.

1. Elizabeth E. Drigotas, *Cash Balance Plans: An Overview*, 28 TAX MGMT. COMPENSATION PLAN. J. 39, 40 (2000).

2. Douglas E. Motzenbecker, *Recent Case Law Developments Affecting Cash Balance Pension Plans*, 17 LAB. LAW. 285, 285 (2001-02). For an explanation of hybrid defined benefit plans, see *infra* Part II.C.

3. Motzenbecker, *supra* note 2, at 289; *Simplifying Defined Benefit Plans*, [2002 Transfer Binder] N.Y.U. Rev. of Employee Ben. & Exec. Compensation (MB) 13-1, 13-53 (July 2002) [hereinafter *Simplifying Defined Benefit Plans*].

4. *See* Jonathan Barry Forman & Amy Nixon, *Cash Balance Pension Plan Conversions*, 25 OKLA. CITY U. L. REV. 379, 393 (2000); Edward A. Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX REV. 683, 685, 697 (2000) [hereinafter Zelinsky, *Cash Balance*]; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-58 to 13-59. Provided that employers protect their employees' already earned benefits, they may convert their traditional defined benefit plans into cash balance pension plans. Forman & Nixon, *supra*, at 384; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-59. The applicable law permits employers to reduce future accruals or even terminate a pension plan provided that employees' accrued benefits are not reduced. Forman & Nixon, *supra*, at 384; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-59. When a traditional defined benefit plan is converted to a cash balance pension plan, however, older employees may lose a significant portion of their expected future benefit. Forman & Nixon, *supra*, at 393; Zelinsky, *Cash Balance*, *supra*, at 685, 697; *Four Uneasy Pieces: Fourth Piece: A Cash Balance Primer for the Largely Uninvolved Practitioner with Only an Occasional Need to Know Fancy Pension Law*, [2001 Transfer Binder] N.Y.U. 59th Inst. on Fed. Tax'n (MB) at 9-6 (2001) [hereinafter *Fourth Piece*]; *Simplifying Defined Benefit*

Although the conversion from traditional defined benefit plans to cash balance pension plans creates the most noticeable adverse effect on older employees,[5] critics argue that the cash balance design itself is inherently age discriminatory.[6] Until *Cooper v. IBM Personal Pension Plan*,[7] however, neither the courts that had considered this argument nor the Internal Revenue Service (IRS), which is primarily responsible for implementing the age discrimination regulations,[8] had found the cash balance pension plan design to be age discriminatory.[9] Despite prior precedent that provides support for the cash balance design, in *Cooper*, the U.S. District Court for the Southern District of Illinois interpreted the age discrimination provisions of the Employee Retirement Income Security Act of 1974 (ERISA) in a manner that would result in cash balance pension plans being declared inherently age discriminatory. If this interpretation prevails, employers will most likely abandon their cash balance pension plans, a result not favored by public policy considerations.[10]

This note explains the manner in which the *Cooper* court misinterpreted the age discrimination provisions of ERISA, and that according to the correct interpretation, cash balance pension plans are not inherently age discriminatory. Part II of this note provides a brief comparison of various pension plan designs. Part III explores the various statutes and prior case law that are applicable to cash balance pension plans, as well as pension equity plans. Part IV provides a detailed analysis of the case of *Cooper v. IBM Personal Pension Plan*. Finally, Part V details how the *Cooper* court misinterpreted the applicable age discrimination requirements of ERISA and concludes that IBM's pension plan designs are not inherently age discriminatory according to the correct legal analysis.

Plans, *supra* note 3, at 13-59. Unlike employees' accrued benefits, the law does not protect employees' expected future benefits. *Fourth Piece*, *supra*, at 9-6; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-59.

5. Eaton v. Onan, 117 F. Supp. 2d 812, 818 (S.D. Ind. 2000); Motzenbecker, *supra* note 2, at 290; *Fourth Piece*, *supra* note 4, at 9-6.

6. *See* Zelinsky, *Cash Balance*, *supra* note 4, at 761; *Fourth Piece*, *supra* note 4, at 9-10.

7. 274 F. Supp. 2d 1010 (S.D. Ill. 2003).

8. Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47,713, 47,713 (Aug. 10, 1978); *see* H.R. REP. NO. 99-1012, at 378-79 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4025.

9. *See infra* Parts III.B, III.C, III.D.

10. *See infra* Part V.C.

II. An Overview of Employee Benefit Plans

Currently, the United States has a "voluntary pension system."[11] Thus, employers are not required to establish a retirement plan for their employees.[12] If, however, employers establish a pension plan for the benefit of their employees, the plan must comply with the applicable provisions of both the Internal Revenue Code (IRC)[13] and ERISA,[14] which provide a regulatory framework for two types of retirement plans: defined benefit plans and defined contribution plans.[15]

A. Defined Benefit Plans

A traditional defined benefit plan guarantees employees a specific benefit at retirement determined pursuant to a formula specified in the particular company's plan.[16] Such benefit is typically paid at retirement in the form of an annuity over the employee's life.[17] A common formula used for this type of plan defines the pension benefit as a certain percentage of employees' final average compensation multiplied by the number of years that they worked for the company.[18] Normally, employees' final average compensation equals the average of their highest three- or five-year earnings at the end of their career.[19] Consequently, traditional defined benefit plans typically provide more valuable benefits during the final years of employees' careers.[20] Thus, older employees with longer years of service

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11. Forman & Nixon, *supra* note 4, at 383.
12. *Id.*
13. 26 U.S.C. §§ 401-457 (2000).
14. 29 U.S.C. §§ 1001-1461 (2000).
15. 26 U.S.C. §§ 401-457; 29 U.S.C. §§ 1001-1461; *see also* Drigotas, *supra* note 1, at 39.
16. Drigotas, *supra* note 1, at 39.
17. *Id.*
18. Forman & Nixon, *supra* note 4, at 386. For example, a typical defined benefit plan may calculate retirement benefits using a formula equal to 2% multiplied by years of service multiplied by final average compensation. *See id.* at 385-86. If an employee worked for thirty years with a final average compensation of $60,000, his retirement benefit would equal $36,000 (.02 × 30 × $60,000). *See id.*
19. *Id.* at 386; *see* Drigotas, *supra* note 1, at 39.
20. Drigotas, *supra* note 1, at 41 (noting that under a traditional defined benefit plan, "accruals during the early years of service are relatively small, with a substantial portion of accruals coming towards the end of a participant's career"); Forman & Nixon, *supra* note 4, at 388-89 (explaining that the design of a traditional defined benefit plan provides employees with a financial incentive to work for the same employer throughout their entire careers and penalizes mobile workers).

benefit most from the traditional defined benefit design, while younger, more mobile workers are disadvantaged by the plan's emphasis on employees' highest average compensation and number of years of service.[21]

Given that employers must guarantee a specific benefit to employees at termination of employment under a defined benefit plan, the amount of the benefit is unaffected by the investment performance of the plan assets.[22] Employers bear the risk of investment and the Pension Benefit Guaranty Corporation (PBGC) insures a portion of the accrued benefits in the event that employers are unable to fund the guaranteed benefits.[23]

B. Defined Contribution Plans

Under a typical defined contribution plan, employers deposit annual benefits into individual investment accounts maintained for each employee who participates in the plan.[24] In general, the annual contribution to each account is a specified percentage of the particular employee's salary.[25] Unlike a defined benefit plan, employers do not guarantee the amount of the benefit.[26] Rather, employees bear the risk of investment and are not entitled to a specific benefit amount at retirement.[27] Employees' benefits are based on the balance of their individual investment accounts, and employees are usually entitled to their vested account balance at termination of employment.[28] Accordingly, the benefit amount received by participants equals the value of employer contributions to their individual investment accounts plus or minus any investment gains or losses on such contributions.[29]

In addition, defined contribution plans are more readily transferable than defined benefit plans.[30] Younger, more mobile workers benefit from the portability of a defined contribution plan, which makes it more convenient

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21. *See* Forman & Nixon, *supra* note 4, at 388-89; Drigotas, *supra* note 1, at 41.

22. Motzenbecker, *supra* note 2, at 286.

23. 29 U.S.C. §§ 1301-1461 (2000); *see* Forman & Nixon, *supra* note 4, at 385-86; Motzenbecker, *supra* note 2, at 286.

24. Motzenbecker, *supra* note 2, at 287.

25. Forman & Nixon, *supra* note 4, at 386. For example, the retirement formula may calculate benefits as 5% of salary. *Id.* "Under such a plan, a worker who earned $30,000 in a given year would have $1500 (5% × $30,000) contributed to [his] individual investment account . . . ." *Id.*

26. Motzenbecker, *supra* note 2, at 287.

27. Zelinsky, *Cash Balance*, *supra* note 4, at 692.

28. Motzenbecker, *supra* note 2, at 287.

29. *Id.*

30. *Id.*

for such workers to change jobs mid-career and take their accrued benefit with them.[31]

C. Hybrid Pension Plans

Certain retirement plans, known as hybrid pension plans, combine the characteristics of defined benefit plans and defined contribution plans.[32] In many cases, employers adopt hybrid pension plans to "garner the relative advantages of each of the separate approaches to plan design in a single plan."[33] Given that the IRC and ERISA only provide a regulatory framework for two types of retirement plans, each hybrid pension plan must be regulated as *either* a defined benefit plan *or* a defined contribution plan, depending on the specific characteristics of the hybrid plan.[34]

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31. *Id.* Defined contribution plans allow employees to accrue benefits more evenly over their careers than defined benefit plans, which provide more valuable benefits during the final years of employees' careers. Drigotas, *supra* note 1, at 41. Thus, employees are not penalized if they decide to change jobs mid-career. Forman & Nixon, *supra* note 4, at 391. At termination of their previous job, employees are entitled to the balance of their account. *Id.*

32. Alvin D. Lurie, *Age Discrimination or Age Justification?: The Case of the Shrinking Future Interest Credits Under Cash Balance Plans*, 54 TAX LAW. 299, 309 (2001) [hereinafter Lurie, *Age Discrimination*].

33. Robert L. Clark et al., *Adopting Hybrid Pension Plans: Financial and Communication Issues*, 17 BENEFITS Q. 7, 7 (2001); *see also Four Uneasy Pieces: Third Piece: Pension Equity Plans Are Not the Evil Things Some Would Have You Believe*, [2001 Transfer Binder] N.Y.U. 59th Inst. on Fed. Tax'n, 8-1, 8-7 (2001) [hereinafter *Third Piece*] (explaining that the increasing use of hybrid pension plans is "driven by the marketplace" and the demands of employees).

34. Lurie, *Age Discrimination*, *supra* note 32, at 309. Congress recognized the combined characteristics of hybrid pension plans through its regulation of target benefit plans. A target benefit plan appears similar to a defined benefit plan but is regulated as a defined contribution plan. *Id.* Using a defined benefit formula, employers contribute a certain amount to each participant's individual account. *Id.* The target amount, however, is not guaranteed at retirement because employees bear the risk of investment. Forman & Nixon, *supra* note 4, at 387; *see* Lurie, *Age Discrimination*, *supra* note 32, at 309. For this reason, a target benefit plan is considered a defined contribution plan and must comply with the applicable statutory provisions regulating defined contribution plans. Lurie, *Age Discrimination*, *supra* note 32, at 309. Section 411(b)(2) of the IRC, 26 U.S.C. § 411(b)(2) (2000), provides age discrimination regulations for defined contribution plans. Section 411(b)(2)(B) of the IRC is titled "Application to target benefit plans," and section 411(b)(2)(C) of the IRC states, "The Secretary shall provide by regulation for the application of the requirements of this paragraph to target benefit plans." 26 U.S.C. § 411(b)(2)(B), (C).

Cash balance pension plans had just been developed at the time the OBRA age discrimination provisions were added in 1986. *See* Drigotas, *supra* note 1, at 39; *see also* Lurie, *Age Discrimination*, *supra* note 32, at 310; *infra* Part III.A. Such timing explains the omission of a similar provision regarding cash balance pension plans in the OBRA age discrimination

1. Cash Balance Pension Plans

A cash balance pension plan is a hybrid pension plan[35] that appears similar to a defined contribution plan but is treated as a defined benefit plan.[36] Therefore, a cash balance pension plan must comply with those portions of the IRC and ERISA that regulate defined benefit plans.[37] A cash balance pension plan resembles a defined contribution plan because participants' benefits are based on their hypothetical account balances.[38] These purely hypothetical accounts, however, are "merely bookkeeping devices for cash balance plans."[39]

A cash balance pension plan is considered a defined benefit plan because it defines the benefit as a specific amount paid by the plan at retirement, rather than as a specific amount contributed each year to an actual individual account.[40] Each year, the hypothetical account typically accumulates both a pay credit, which is a percentage of the employee's salary, and an interest credit, which is a certain percentage of the employee's hypothetical account balance.[41] In contrast to traditional defined benefit plans, which usually provide benefits in the form of a monthly annuity, cash balance pension plans usually provide employees with the option of receiving their retirement income either as a lump sum or as an annuity.[42] Because

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provisions. *See* Lurie, *Age Discrimination*, *supra* note 32, at 310 n.22; *see also infra* Part III.A. However, it also indicates Congress's recognition of the combined characteristics of hybrid benefit plans. Lurie, *Age Discrimination*, *supra* note 32, at 309-10.

35. Forman & Nixon, *supra* note 4, at 387.

36. *Id.* at 394.

37. Drigotas, *supra* note 1, at 39; Motzenbecker, *supra* note 2, at 288.

38. Forman & Nixon, *supra* note 4, at 394-95. A cash balance pension formula calculates benefits similar to a bank account because the allocations to the hypothetical account accrue interest in much the same way as a savings account. *See id.* at 380.

39. *Id.* at 397.

40. U.S. GEN. ACCOUNTING OFFICE, NO. GAO/HEHS-00-207, CASH BALANCE PLANS: IMPLICATIONS FOR RETIREMENT 10 (2000).

41. Forman & Nixon, *supra* note 4, at 381. For example, consider an employee with a hypothetical account balance of $5000, who makes a $30,000 salary in a given year. *See id.* If the cash balance pension plan allots a 7% pay credit and a 5% interest credit, then a $2100 (.07 × $30,000) pay credit and a $250 (.05 × $5000) interest credit will be added to the employee's hypothetical account for that year. *See id.* This will yield a total account balance of $7350. *See id.*

42. *Future of Cash Balance Plans Uncertain After Recent Ruling Against IBM*, [July-Dec. Transfer Binder] 30 PENS. & BEN. REP. (BNA) No. 34, at 1926 (Sept. 2, 2003) [hereinafter *Future of Cash Balance Plans*]. In fact, lump sum payments are very common under a cash balance pension plan. Drigotas, *supra* note 1, at 41.

employers bear the risk of investment, participants are guaranteed the hypothetical account balance regardless of the investment performance of the pension funds.[43] Thus, proponents argue that cash balance plans provide employees with the best of both worlds: the easy-to-understand benefit formula of a defined contribution plan and the investment security of a defined benefit plan.[44]

2. Pension Equity Plans

A pension equity plan is a variant of the cash balance pension plan[45] and has been described by one commentator as "a kissing cousin of cash balance plans."[46] Similar to cash balance pension plans, pension equity plans guarantee a certain benefit to employees and allocate that benefit to their hypothetical accounts.[47] Instead of defining the hypothetical account balance in terms of pay credits and interest credits, a pension equity plan often defines the benefit in terms of annual percentages, also known as credits,[48] which are multiplied by employees' final average earnings.[49] Annual credits can be based on employees' ages, years of service with the employer, or a combination of both.[50] Annual credits are added to

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43. Drigotas, *supra* note 1, at 41; Forman & Nixon, *supra* note 4, at 397; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-56. In actuality, plan assets are not allocated to participants' accounts, which are purely hypothetical. Drigotas, *supra* note 1, at 40. Rather, such assets are pooled and invested at the direction of the employer, which bears the risk and reward of the investment. *Future of Cash Balance Plans*, *supra* note 42, at 1926.

44. *See* Drigotas, *supra* note 1, at 41; Motzenbecker, *supra* note 2, at 288. Because cash balance pension plans are considered defined benefit pension plans, they are insured by the PBGC. *Future of Cash Balance Plans*, *supra* note 42, at 1926.

45. *Third Piece*, *supra* note 33, at 8-6.

46. *Courts Take the Juice out of Cash Balance Plans*, [2003] 100 TAX NOTES (Tax Analysts) No. 8, at 994 (Aug. 25, 2003).

47. *Third Piece*, *supra* note 33, at 8-6; *see* Bernard Green, *What Is a Pension Equity Plan? at* http://www.bls.gov/opub/cwc/cm20031016ar01p1.htm (Oct. 29, 2003).

48. Green, *supra* note 47.

49. Zelinsky, *Cash Balance*, *supra* note 4, at 694. Employees' final average earnings are generally defined as their highest annual salary, usually over the last three or five years before termination of employment. Green, *supra* note 47. Like defined benefit plans, pension equity plans define the benefit in terms of employees' final average pay. *Third Piece*, *supra* note 33, at 8-4. Consequently, pension equity plans provide more valuable benefits during the final years of employees' careers, thus providing the greatest benefits to older, longer-service employees. *Id.*

50. *Third Piece*, *supra* note 33, at 8-5; Green, *supra* note 47. If the plan defines the annual credits in terms of employees' ages, then for example, a thirty-year-old to thirty-five-year-old may accumulate 3.0 credits annually, a thirty-six-year-old to forty-year-old may accumulate 4.0 credits annually, a forty-one-year-old to forty-five-year-old may accumulate 5.0 credits annually,

employees' hypothetical accounts each year until termination of employment, and at that time, the total percentage is multiplied by employees' final average earnings.[51] The result is a lump-sum benefit, which can be converted into an annuity if the employee so chooses.[52] Because the benefit is normally expressed as a lump sum, "from an age discrimination perspective, pension equity plans are virtually identical to cash balance plans."[53] While most of the authority cited below demonstrates that cash balance pension plans are not inherently age discriminatory, the same reasoning also indicates that pension equity plans do not inherently discriminate on the basis of age.[54]

III. Statutes and Prior Case Law

A. Defined Benefit Pension Plans and the Applicable Age Discrimination Statutes

Federal law consists of three parallel age discrimination provisions that govern pension plans: section 204(b)(1)(H) of ERISA,[55] section 411(b)(1)(H) of the IRC,[56] and section 4(i) of the Age Discrimination in Employment Act of 1967 (ADEA).[57] Section 204(b)(1)(H) of ERISA and section 411(b)(1)(H) of the IRC contain identical provisions that state in relevant part, "A defined benefit pension plan shall be treated as not

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etc. Green, *supra* note 47. If the plan defines the annual credits in terms of employees' years of service, then for example, an employee may accumulate 10% annually for the first ten years of service, 20% annually for the next ten years of service, etc. Zelinsky, *Cash Balance*, *supra* note 4, at 694.

51. *Third Piece*, *supra* note 33, at 8-5; Green, *supra* note 47. For example, if a pension equity plan credits participants 10% annually and an employee retires after five years, he will have a hypothetical account balance of 50% (10% × 5) multiplied by his final average earnings. Zelinsky, *Cash Balance*, *supra* note 4, at 694. If the employee retires after twenty years, he will have a hypothetical account balance of 200% (10% × 20) multiplied by his final average earnings. *Id.*

52. *Third Piece*, *supra* note 33, at 8-6; Green, *supra* note 47.

53. Brief of Amici Curiae: The American Benefits Council and the ERISA Industry Committee: In Opposition to Plaintiffs' Motion for Entry of Remedial Relief and in Support of Defendants' Cross-Motion for Summary Judgment Denying Retroactive Relief at 10, Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) (No. 99-829) *at* http://www.americanbenefitscouncil.org/documents/ibm_amicus_brief2003.pdf (last visited June 27, 2004) [hereinafter Brief of Amici Curiae].

54. *Id.*

55. 29 U.S.C. § 1054(b)(1)(H) (2000).

56. 26 U.S.C. § 411(b)(1)(H) (2000).

57. 29 U.S.C. § 623(i).

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."[58] Similarly, section 4(i) of the ADEA prohibits employers from establishing or maintaining a pension plan that "requires or permits . . . the cessation of an employee's benefit accrual, or the reduction of the rate of an employee's benefit accrual because of age."[59] Although the IRC, ERISA, and the ADEA all prohibit the reduction of the "rate of an employee's benefit accrual" based on age, none of these provisions defines the term "rate of an employee's benefit accrual."[60]

These three age discrimination provisions were added to their respective statutes as a part of the Omnibus Budget Reconciliation Act of 1986 (OBRA).[61] According to the OBRA Conference Report, these three provisions should be "interpreted in a consistent manner and [the Committee does] not intend any differences in language in the provisions to create an inference that a difference exists among such provisions."[62]

B. Eaton v. Onan Corp.:[63] Cash Balance Pension Plans Are Not Inherently Age Discriminatory

In December 1994, the Onan Corporation converted its traditional defined benefit plan to a cash balance pension plan retroactive to January 1989.[64] Onan converted benefits accrued by participants before January 1989 into opening hypothetical account balances and did not deprive employees of any benefits that accrued before January 1989.[65] Under Onan's cash balance pension plan, participants' hypothetical accounts received annual "pay-based credits" and annual "interest credits."[66]

Plaintiffs-employees sued Onan, claiming that the company's cash balance pension plan violated the age discrimination provisions of section 204(b)(1)(H) of ERISA and section 4(i) of the ADEA by reducing the "rate

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58. 26 U.S.C. § 411 (b)(1)(H)(i); 29 U.S.C. § 1054(b)(1)(H)(i).

59. 29 U.S.C. § 623(i).

60. 26 U.S.C. § 411(b)(1)(H); 29 U.S.C. § 1054 (b)(1)(H); *see also* Forman & Nixon, *supra* note 4, at 421.

61. Pub. L. No. 99-509, 100 Stat. 1874 (codified as amended at 29 U.S.C. § 623, 29 U.S.C. § 1054(a), 26 U.S.C. § 411).

62. H.R. REP. NO. 99-1012, at 378-79 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4023-24.

63. 117 F. Supp. 2d 812 (S.D. Ind. 2000).

64. *Id.* at 819.

65. *Id.*

66. *Id.*

of an employee's benefit accrual" in accordance with age.[67] Plaintiffs conceded that neither the pay credits nor the interest credits under the Onan cash balance pension plan depended in any way on an employee's age.[68] Nevertheless, Plaintiffs contended that the law required employees' benefits to be defined in terms of an annuity commencing at normal retirement age, rather than in terms of current pay and interest credits.[69] Plaintiffs argued that the court should apply the definition of "accrued benefit" to the term "rate of an employee's benefit accrual."[70] Both the IRC and ERISA explicitly define the term "accrued benefit" as an employee's benefit expressed in the form of an annuity commencing at age sixty-five.[71] When measured in terms of an age sixty-five annuity,[72] plaintiffs argued that "the rate of an employee's benefit accrual" decreases with age.[73]

In contrast, Defendant-employer argued that the OBRA age discrimination provisions do not apply to employees younger than age sixty-five and that even if they did, Congress did not explicitly require, or intend, for the "rate of an employee's benefit accrual" to be measured solely in terms of an age sixty-five annuity.[74] Defendant asserted that the "rate of an employee's benefit accrual" could be measured in terms of the annual change in the balance of a participant's hypothetical account.[75] When defined in such terms, the "rate of an employee's benefit accrual" does not decrease with age.[76]

Accordingly, the main issue confronting the U.S. District Court for the Southern District of Indiana in *Eaton* was one of statutory interpretation.[77] The court agreed with Defendant that the age discrimination provisions of section 204(b)(1)(H) of ERISA and section 4(i) of the ADEA were ambiguous and failed to specifically define the term "rate of an employee's

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67. *Id.* at 823. "Plaintiffs also believe [Onan's cash balance pension plan] violates the parallel provision of the [IRC], but they realize they have no standing to enforce that provision directly." *Id.*

68. *Id.*

69. *Id.*

70. *Id.* at 824.

71. 26 U.S.C. § 411(a)(7)(A)(I) (2000); 29 U.S.C. § 1002(23)(A) (2000); *see also Eaton*, 117 F. Supp. 2d at 824.

72. An annuity is "[a]n obligation to pay a stated sum, usu[ally] monthly or annually, to a stated recipient." BLACK'S LAW DICTIONARY 88 (7th ed. 1999). Thus, an age sixty-five annuity is an annuity that commences when the recipient reaches the age of sixty-five.

73. *Eaton*, 117 F. Supp. 2d at 823.

74. *Id.* at 824.

75. *Id.*

76. *Id.*

77. *Id.* at 823.

benefit accrual."[78] According to the court, "When dealing with such statutory ambiguities, the courts look for guidance from many sources, including legislative history, the broader purposes of the legislation at issue, including evidence of the limitations and compromises made in Congress, as well as common sense and the practical limitations of the alternative interpretations."[79] When courts interpret an ambiguous statute, conference reports are considered the most persuasive indication of congressional intent.[80] According to Judge Hamilton, who authored the *Eaton* opinion, "The [OBRA] Conference Report shows that Congress was addressing [the] issue of pension benefits of employees who continued working after they reached the age of 65."[81] In addition to conference reports, courts also consider the statements of legislators who sponsored the statute persuasive in determining congressional intent.[82] When Senator Grassley, one of the sponsors of OBRA, first introduced the 1985 age discrimination provisions he stated, "I am introducing legislation today that would amend the [ADEA] and [ERISA] to require continued pension benefit accruals for workers who work past the normal retirement age of 65."[83] Furthermore, the court stated that the only example included in the conference report concerned the benefit accruals of a participant working beyond age sixty-five.[84] The example retirement plan contained in the OBRA Conference Report provides an annuity of $10 per month for each year of employment.[85] Thus, if a participant worked for ten years, he would be entitled to $100 per month

78. *Id.* at 825.

79. *Id.*

80. *Id.* at 827.

81. *Id.* at 828.

82. *Id.* at 827.

83. *Id.* at 828 (quoting 131 CONG. REC. 18,868 (1985)). Representative Jeffords, speaking in support of the OBRA Conference Report, stated that "the bill before [Congress] is also a pension bill which extends valuable pension accrual protections to older Americans who work beyond normal retirement age." *Id.* (quoting 132 CONG. REC. 32,963 (1986)). Similarly, Representative Roukema said, "The legislation amends current law to preclude the 'attainment of any age' as a reason for eliminating or reducing pension benefit accruals after normal retirement age." *Id.* (quoting 132 CONG. REC. 32,975 (1986)). In addition, Representative Clay added that "these changes will assure that older Americans who work beyond normal retirement age continue to earn pension credits." *Id.* (quoting 132 CONG. REC. 32,975 (1986)). Finally, Representative Hawkins stated that under this legislation, "[Employees] who work beyond normal retirement age will continue earning pension credit." *Id.* at 828-29 (quoting 132 CONG. REC. 32,975 (1986)).

84. *Id.* at 829.

85. H.R. REP. NO. 99-1012, at 378-79 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4026; *see Eaton*, 117 F. Supp. 2d at 829.

at retirement.[86] According to the OBRA Conference Report, "The plan is required to provide an additional benefit of $10 per month for each year of service after age 65."[87] In addition, the court recognized that the IRC's age discrimination provision heading reads: "Continued accrual beyond normal retirement age."[88] Therefore, the court concluded that Congress intended to apply the provisions regulating the "rate of an employee's benefit accrual" *only* to those employees who choose to work past normal retirement age.[89]

Even assuming that the age discrimination provisions apply to employees who are younger than normal retirement age, the court determined that neither the IRC nor ERISA explicitly require the "rate of an employee's benefit accrual" to be measured solely in terms of an age sixty-five annuity.[90] According to Judge Hamilton, "The concept of the 'benefit accrual rate' does not have a single, self-evident meaning, especially in the complex world of pension plan regulation. The term is used and defined in different ways and for different purposes under ERISA and the [IRC]."[91]

The court provided several reasons for its conclusion. First, the court determined that measuring the "rate of an employee's benefit accrual" in terms of an annuity commencing at age sixty-five would not make sense when determining the benefits of a participant older than age sixty-five.[92] The court recognized that participants working past normal retirement age were "at least a major focus" of these provisions.[93] In addition, the court reasoned that the OBRA Conference Report example would no longer be accurate because when benefits earned after age sixty-five are converted into an age sixty-five annuity, the resulting annuity decreases as the employee's age increases because of the time value of money.[94] Given that the OBRA

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86. *See* H.R. REP. NO. 99-1012, at 378-79, *reprinted in* 1986 U.S.C.C.A.N. at 4026; *Eaton*, 117 F. Supp. 2d at 829.

87. *Eaton*, 117 F. Supp. 2d at 829 (quoting H.R. REP. NO. 99-1012, at 381, *reprinted in* 1986 U.S.C.C.A.N. at 4026).

88. *Id.* at 826 (quoting 26 U.S.C. § 411(b)(1)(H) (2000)).

89. *Id.* at 829.

90. *Id.* at 829-30.

91. *Id.* at 830.

92. *Id.*

93. *Id.*

94. *Id.* "[A]n annuity of $10 per month beginning at age 65 is worth more than an annuity of $10 per month beginning at age 66." *Id.* If the employee's post normal retirement annuity of $10 per month is converted into an age sixty-five annuity, then a sixty-six-year-old will only earn $8.90 per month, a sixty-seven-year-old will only earn $7.90 per month, a sixty-eight-year-old will only earn $7.00 per month, and so on. Richard C. Shea et al., *Age Discrimination in Cash Balance Plans: Another View*, 19 VA. TAX REV. 763, 769 (2000). Hence, the value of the annuity decreases as the employee ages, which is the exact result Congress intended to prohibit. *See id.*

Conference Report example was included to illustrate a pension plan that complies with the age discrimination provisions, Judge Hamilton reasoned that Plaintiffs's interpretation was incorrect because it "would transform that example of compliance into an example of a violation."[95]

The court also recognized that common sense and public policy implications may be considered when statutory language is ambiguous.[96] As a matter of public policy, "the rate of an employee's benefit accrual" may decline provided that the decline is not tied to age.[97] The rate can decline with a participant's years of service, and employers can completely stop future accruals by placing a cap on years of service or on a certain dollar amount of benefits.[98] Moreover, according to the court, Plaintiffs failed to offer any public policy rationale that would be advanced by defining the term "rate of an employee's benefit accrual" as an annuity commencing at age sixty-five.[99]

Recognizing that the results complained of by Plaintiffs were caused by the time value of money and not age discrimination, the court explained that:[100]

> All other things being equal, the service credit for a younger employee adds more to the value of an annuity payable at that employee's normal retirement age than an identical service credit for an older employee. The younger employee's service credit will earn interest credits for more years than the older employee's before each reaches the age of normal retirement. This effect is inherent in virtually any cash balance pension plan design.[101]

Because of the interest credit, the court reasoned that if the OBRA age discrimination provisions require the "rate of an employee's benefit accrual" to be measured in terms of an age sixty-five annuity, then the cash balance pension plan design would be deemed inherently age discriminatory and

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95. *Eaton*, 117 F. Supp. 2d at 830.

96. *Id.* at 831.

97. *Id.* at 831-32.

98. *Id.* at 832.

99. *Id.* at 831. Plaintiffs raised public policy concerns about the conversion from a traditional defined benefit plan to a cash balance pension plan. *Id.* at 831 n.9. However, "[i]ssues related to plan conversions . . . are different from plaintiffs' age discrimination claims asserted here, which would effectively outlaw cash balance plans." *Id.*

100. *Id.* at 831, 833.

101. *Id.* at 823.

"hundreds of cash balance plans with millions of participants will be declared illegal.[102]

Thus, the court concluded that under a cash balance pension plan, the "rate of an employee's benefit accrual" should be measured in terms of the annual change in the hypothetical account balance or an annuity beginning on a particular date.[103] When measured by either of these methods, Judge Hamilton determined that Onan's cash balance pension plan did not discriminate on the basis of age.[104] Accordingly, the *Eaton* court held that the cash balance plan maintained by Onan did not violate section 204(b)(1)(H) of ERISA or section 4(i) of the ADEA.[105]

C. Additional Support for Cash Balance Pension Plans: Engers v. AT&T and Campbell v. BankBoston

In *Engers v. AT&T*,[106] Plaintiffs-employees claimed that AT&T's cash balance pension plan violated the age discrimination provisions of ERISA and the ADEA.[107] Until 1997, AT&T maintained a traditional defined benefit plan that provided employees with an annuity at retirement based on employees' years of plan participation and their average pay over a certain period of time specified in the plan.[108] In 1997, AT&T converted its traditional defined benefit plan to a cash balance pension plan.[109] AT&T's cash balance pension plan defined each participating employee's benefit by reference to a hypothetical account, which annually accrued a certain percentage of the employee's salary and a certain percentage of interest.[110] After determining that section 204(b)(1)(H) of ERISA and section 4(i) of the ADEA were ambiguous, the U.S. District Court for the District of New Jersey considered OBRA's legislative history and the *Eaton v. Onan* decision.[111] Accordingly, the court held that these provisions applied only to employees who chose to work past the normal retirement age of sixty-five and dismissed the Plaintiffs' age discrimination claim.[112]

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102. *Id.*
103. *Id.* at 832-33.
104. *Id.* at 833.
105. *Id.* at 815.
106. No. 98-3660, 2000 U.S. Dist. LEXIS 10937 (D.N.J. June 29, 2000).
107. *Id.* at *3.
108. *Id.* at *5.
109. *Id.*
110. *Id.*
111. Engers v. AT&T, No. 98-3660, at 8 (D.N.J. June 6, 2001) (unreported letter op.) (on file with author).
112. *Id.* at 10-11.

In *Campbell v. BankBoston*,[113] a former employee argued that BankBoston's cash balance pension plan violated the age discrimination provision of ERISA.[114] On appeal, the U.S. Court of Appeals for the First Circuit refused to decide this issue because it was not initially raised in district court.[115] The appellate court, however, discussed the issue in dicta by essentially reiterating the holding in *Eaton*.[116] The court stated that section 204(b)(1)(H) of ERISA *only* applies to employees older than normal retirement age, as evidenced by this section's legislative history.[117] In addition, the court indicated that even if this provision applied to employees younger than normal retirement age, ERISA does not require that the "rate of an employee's benefit accrual" be measured solely in terms of an age sixty-five annuity.[118]

D. The IRS and the Treasury Department Support the Cash Balance Pension Plan Design: Notice 96-8, the Preamble to the 1991 Nondiscrimination Regulations, and the 2002 Proposed Treasury Regulations

The IRS and the Treasury Department retain primary jurisdiction over the implementation of regulations relating to the age discrimination provisions of the IRC and ERISA.[119] On several occasions, the IRS has concluded that cash balance pension plans are not inherently age discriminatory.

In 1996, the IRS published Notice 96-8,[120] which provides guidance to cash balance pension plan sponsors regarding interest credits.[121] By issuing Notice 96-8, the IRS indicated its support for cash balance pension plans and implicitly concluded that cash balance pension plans do not violate the age discrimination provisions of the IRC.[122] Notice 96-8 states that only front-loaded interest credit plans comply with the IRC.[123] Under frontloaded cash

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113. 327 F.3d 1 (1st Cir. 2003).
114. *Id.* at 9.
115. *Id.* at 10.
116. *Id.*
117. *Id.*
118. *Id.*
119. Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47,713, 47,713 (Aug. 10, 1978); *see* H.R. REP. NO. 99-1012, at 378-79 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4025 ("The conference agreement authorizes the Treasury to issue regulations coordinating the continuing benefit accrual requirements with other requirements, including . . . the [ADEA].").
120. 1996-1 C.B. 359.
121. *Id.*
122. *See id.*
123. *Id.* at 360-61. Notice 96-8 states that a cash balance pension plan with backloaded

balance pension plans, future interest credits are *not* conditioned on future service.[124] Accordingly, if employees terminate employment before normal retirement age and elect to defer receipt of their retirement benefits until that time, their hypothetical accounts *must* continue to accrue interest credits.[125] Consequently, when determining whether a cash balance pension plan complies with the IRC's requirements, "[t]he benefits attributable to future interest credits with respect to a hypothetical allocation accrue at the same time that the benefits attributable to the hypothetical allocation accrue."[126] In other words, when an employee receives a certain pay credit, all of the interest that will accrue on that particular pay credit up until the employee reaches normal retirement age *must* be taken into account at the time that the pay credit is earned in determining the balance of the employee's hypothetical account.[127] The effect of frontloaded interest "is the very feature that attracts the age discrimination argument."[128] Under a frontloaded cash balance plan, younger employees receive higher age sixty-five annuities than older employees because younger employees will accrue interest credits over a longer period of time.[129] Therefore, by issuing Notice 96-8, the IRS concluded that cash balance pension plans do not violate the age discrimination provisions of the IRC.

The IRS had previously determined that cash balance pension plans comply with the age discrimination requirements of the IRC through regulations issued in 1991. The preamble to the 1991 nondiscrimination regulations[130] states, "The fact that interest adjustments through normal retirement age are accrued in the year of the related hypothetical allocation will not cause a cash balance pension plan to fail to satisfy the [age

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interest credits would not comply with the anti-backloading rules of section 411(b) of the IRC. *Id.* Backloaded interest credit plans condition future interest credits upon future service. *Id.* at 360. Accordingly, interest is not earned until it is credited to employees' hypothetical accounts. *Id.* at 360-61. If each interest credit is treated as having accrued in the year in which it is credited to employees' accounts, then the interest credit in the last few years before retirement would "exceed by many fold the combined pay and interest credits in the first few years of plan participation, because of the effect of compounding interest over a long period." Michael S. Horne, ERISA Indus. Comm., *Are Cash Balance Pension Plans Inherently Unlawful Under the Age Discrimination and Employment Act?*, Aug. 1, 2003, *at* http://www.eric.org.

124. I.R.S. Notice 96-8, 1996-1 C.B. 359, 360.

125. *Id.*

126. *Id.*

127. *See id.*

128. Lurie, *Age Discrimination*, *supra* note 32, at 321.

129. *See id.*

130. Treas. Reg. § 1.401(a)(4) (1991).

discrimination rules]."[131] Although preambles to regulations carry no legal authority, the language of this preamble clearly indicates that the IRS does not consider cash balance pension plans inherently age discriminatory.[132]

In December 2002, the Treasury Department and the IRS issued proposed regulations[133] to "provide long-needed guidance on significant questions about cash balance plans."[134] Although the Treasury Department and the IRS recently withdrew these proposed regulations, their issuance continues to demonstrate that these agencies regard cash balance pension plans as consistent with the age discrimination provisions of the IRC.[135] If the Treasury Department and the IRS had adopted these regulations, they would have applied the age discrimination rules that pertain to defined contribution plans to cash balance pension plans.[136] According to the formerly proposed regulations, "[A] participant's rate of benefit accrual for a plan year is to be determined as the addition to the participant's hypothetical account for the plan year."[137] The future interest credits would have been disregarded in

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131. *Id.*

132. Shea et al., *supra* note 94, at 779; *Specialized Qualified Plans-Cash Balance, Target, Age-Weighted and Hybrids*, [2001] 352 3d Tax Mgmt. (BNA) A-1, A-49 (2001).

133. Prop. Treas. Reg. § 1.411(b), 67 Fed. Reg. 76,123 (Dec. 11, 2002).

134. Press Release, The Office of Public Affairs, Treasury and IRS Propose Regulations for Cash Balance Plans (Dec. 10, 2002) *at* http://www.ustreas.gov/press/releases/po3676.htm [hereinafter Proposed Regulations for Cash Balance Plans].

135. On June 15, 2004, the Treasury Department and the IRS withdrew the proposed regulations "to provide Congress with an opportunity to review and consider a legislative proposal on cash balance pension plans that was included in the Administration's Budget for Fiscal Year 2005." Press Release, The Office of Public Affairs, Treasury and IRS Withdraw Proposed Cash Balance Regulations (June 15, 2004) *at* http://www.treas.gov/press/releases/js1724.htm. The proposed legislation also declares that cash balance pension plans do not violate the OBRA age discrimination provisions "as long as they treat older workers at least as well as younger workers." Press Release, The Office of Public Affairs, Preserving Cash Balance Plans for Workers: Treasury Proposes Legislation to Protect Defined Benefit Plans and Ensure Fair Treatment of Older Workers in Cash Balance Conversions (Feb. 2, 2004) *at* http://www.ustreas.gov/press/releases/js1132.htm. Hence, it appears that the formerly proposed regulations continue to demonstrate the Treasury Department's determination that cash balance pension plans are not inherently age discriminatory.

136. Proposed Regulations for Cash Balance Plans, *supra* note 134.

137. Prop. Treas. Reg. § 1.411(b)(iii) (A), 67 Fed. Reg. 76,123 (Dec. 11, 2002). The formerly proposed regulations would have applied the age discrimination provisions to employees younger than normal retirement age, contrary to the determination in *Eaton v. Onan*, 117 F. Supp. 2d 812, 815 (S.D. Ind. 2000), that the age discrimination provisions were enacted to protect the benefit accruals of older workers. Steven Pavlick & Paul M. Hamburger, *Effects of Recently Issued Proposed IRS Regulations on the Qualification of Cash Balance Pension Plans*, 31 TAX MGM'T COMPENSATION PLAN. J. 91, 91 n.3 (2003).

determining the balance of an employee's hypothetical account provided that the participant retained the right to receive future interest credits without regard to future service.[138] Accordingly, "a cash balance plan would satisfy the age discrimination rules if the pay credits to an employee's account are not less than the pay credits that would be made if that same employee were younger."[139]

IV. Statement of the Case: Cooper v. IBM Personal Pension Plan

Notwithstanding the prior IRS guidance, in *Cooper v. IBM Personal Pension Plan*,[140] the U.S. District Court for the Southern District of Illinois concluded that IBM's cash balance pension plan, as well as its pension equity plan, violated the age discrimination provisions of ERISA.[141] Before 1995, IBM maintained a traditional defined benefit plan. IBM amended the design of its pension plan in 1995 and again in 1999.[142]

In 1995, IBM implemented a pension equity plan.[143] Participants in IBM's pension equity plan accumulated benefits in the form of "base points" and "excess points."[144] For each year of service, employees received a

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138. Alvin D. Lurie, *Murphy's Law Has IBM Singing the Blues*, *at* http://www.benefitslink.com/articles/lurie20030924.pdf (Sept. 24, 2003) [hereinafter Lurie, *Murphy's Law*].

139. Proposed Regulations for Cash Balance Plans, *supra* note 134. The formerly proposed regulations would have only applied to "eligible cash balance plans." *Treasury, IRS Issue Long-Anticipated Proposed Cash Balance Guidance*, DELOITTE'S WASH. BULL. (Dec. 16, 2002) *at* http://www.benefitslink.com/articles/washbull021216.shtml. To qualify as an "eligible cash balance plan," the plan must satisfy each of the following: (1) the normal form of the benefit must be stated as the balance of the hypothetical account, and (2) as a participant accrues pay credits, the participant must also accrue the right to all future interest payments that will accrue on that pay credit. *Id.* Pension equity plans do not satisfy the definition of "eligible cash balance plans." Pavlick & Hamburger, *supra* note 137, at 92. Therefore, pension equity plans would not have been protected if the Treasury Department had adopted the proposed regulations. *See id.*

140. 274 F. Supp. 2d 1010 (S.D. Ill. 2003).

141. *Id.* at 1017, 1022.

142. *Id.* at 1012.

143. *Id.* According to IBM, the company changed its plan design in 1995 to better address its current business needs. Defendants' Motion for Summary Judgment on Plaintiff's § 204(b)(1)(H) Claim with Respect to IBM's Pension Credit Formula at 3, Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) (No. 99-829) (on file with author) [hereinafter Defendants' Motion]. Before 1995, IBM maintained a traditional defined benefit plan that was most advantageous to employees who had worked for IBM throughout their entire careers. Defendants' Motion, *supra*, at 3; *see Cooper*, 274 F. Supp. 2d at 1012. As an increasing number of employees began changing jobs mid-career, IBM saw the need for a new pension plan design. Defendants' Motion, *supra*, at 3.

144. *Id.*

certain number of base points, depending on their current age, and a certain number of excess points if their earnings[145] exceeded their social security compensation.[146] Both base points and excess points were capped at 425 points and 75 points respectively.[147] Each year, base points were multiplied by employees' earnings, and any excess points earned were multiplied by the amount that the earnings exceeded the social security compensation.[148] These two numbers were then added together and divided by 100 to obtain a dollar amount known as the Pension Credit Value, which represented the total amount of benefits earned by the employee.[149] To convert the total value of employees' benefits into an annuity, the Pension Credit Value was divided by a Benefit Conversion Factor, which was specified in the plan.[150] Participants in IBM's pension equity plan had the option of taking their annuity immediately upon termination of employment or deferring the annuity until a date as late as normal retirement age.[151]

In 1999, IBM converted its pension equity plan to a cash balance pension plan.[152] Under IBM's cash balance pension plan, a hypothetical account was used to determine a participant's benefit.[153] Each employee's hypothetical account accumulated monthly "pay credits" and "interest credits."[154] Under IBM's cash balance pension plan, pay credits equaled five percent of the employee's salary, and interest credits were one percentage point higher

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145. An employee's earnings were equal to the "average of the employee's highest consecutive five year earnings" at the time of termination. *Id.* at 1014.

146. *Id.*

147. *Id.* at 1012.

148. *Id.* at 1014; *see* Defendants' Motion, *supra* note 143, at 5.

149. *Cooper*, 274 F. Supp. 2d at 1014; *see* Defendants' Motion, *supra* note 143, at 5.

150. *Cooper*, 274 F. Supp. 2d at 1014; *see* Defendants' Motion, *supra* note 143, at 5. For example, if an employee began working for IBM at age twenty-nine, he would earn seven base points and zero excess points under IBM's pension equity plan for his first year of service. *See Cooper*, 274 F. Supp. 2d at 1023. Over the next five years, the employee would earn nine base points per year and one excess point per year (assuming his average consecutive five-year earnings exceeded the social security compensation). *See id.* Upon retirement, the employee would have accumulated fifty-seven points. *See id.* Assuming that the employee's highest average consecutive five-year earnings equaled $50,000, the employee's Pension Credit Value would equal $28,500 ($50,000 × 57/100). *See id.* at 1014. The corresponding annuity would equal $28,500 divided by the Benefit Conversion Factor specified in the plan. *See id.*

151. *Cooper*, 274 F. Supp. 2d at 1013; *see* Defendants' Motion, *supra* note 143, at 4.

152. *Cooper*, 274 F. Supp. 2d at 1012-13. According to the court, IBM amended its pension plan design in 1999 to save money. *Cooper*, 274 F. Supp. 2d at 1020. In fact, the court determined that IBM's conversion to a cash balance pension plan would save the company $500 million. *Id.*

153. *Id.* at 1013.

154. *Id.*

than the present rate of return on a one-year treasury bond.[155] Upon termination of their employment, employees could either withdraw the money from their hypothetical account or defer the receipt of these funds until a later date.[156] Former employees could continue to earn interest credits until they withdrew the money from their hypothetical accounts.[157] Upon withdrawal, employees could receive the balance from their hypothetical accounts in the form of a lump sum or convert the balance into a life annuity.[158]

Plaintiffs claimed that both the 1995 and the 1999 pension plan amendments violated the age discrimination provisions of ERISA.[159] Plaintiffs argued that IBM's pension equity plan violated section 204(b)(1)(H) of ERISA because the "rate of an employee's benefit accrual," when expressed in terms of an age sixty-five annuity, decreased with age.[160] Plaintiffs further asserted that under IBM's pension equity plan, the Benefit Conversion Factor for an annuity commencing at age sixty-five increased with age, causing the "rate of an employee's benefit accrual" to decline with age.[161] Because the Pension Credit Value was divided by the Benefit Conversion Factor,[162] Plaintiffs contended that an increasing Benefit Conversion Factor would cause an older employee to receive a lower age sixty-five annuity when compared to a younger employee — even when both

155. *Id.*
156. *Id.*
157. *Id.*
158. *Id.*
159. *Id.* at 1012. In addition to the age discrimination claim under section 204(B)(1)(H) of ERISA, Plaintiffs asserted two additional claims against IBM's pension equity plan. *Id.* at 1014, 1017. First, Plaintiffs claimed that IBM's pension equity plan violated section 204(b)(1)(G) of ERISA, which prohibits an employer from reducing the amount of employees' already accrued benefits. *Id.* at 1014. Second, Plaintiffs claimed that IBM's pension equity plan violated ERISA's anti-backloading rules. *Id.* at 1017. Backloading is regulated by section 411(b) of the IRC, 26 U.S.C. § 411(b) (2000), and section 204(b) of ERISA, 29 U.S.C. § 1054(b) (2000). The anti-backloading rules prohibit a pension plan from delaying the earning of employees' future benefits until the very end of their careers. Rosina B. Barker & Kevin P. O'Brien, Berger v. Xerox: *Looking for the Law in all the Wrong Places*, 16 BENEFITS LAW J. 5, 10 (2003). Although there are three alternative rules applicable to the accrual of benefits and backloading, most cash balance pension plans are designed to satisfy the "133 percent rule." *Id.* This rule requires that "the rate of benefit accrual in any future year, measured as the age 65 benefit stated as a percentage of pay, not exceed the rate in the current year (or any year in between) by more than 33 percent." *Id.*; *see* 26 U.S.C. § 411(b)(1)(B), 29 U.S.C. § 1054(b)(1)(B).
160. *Cooper*, 274 F. Supp. 2d at 1012.
161. *Id.*
162. *Id.*

employees worked for the same number of years and made an identical salary.[163]

Defendants, IBM Personal Pension Plan and IBM Corporation, argued that Plaintiffs lacked standing to sue on the grounds that section 204(b)(1)(H) of ERISA applies only to employees who have reached normal retirement age.[164] Contrary to Plaintiffs' interpretation of section 204(b)(1)(H) of ERISA, Defendants also contended that the term "rate of an employee's benefit accrual" does not mean the same thing as "accrued benefit" and does not require benefits to be expressed in terms of an age sixty-five annuity.[165] When measured in terms of an age sixty-five annuity, Defendants asserted that the time value of money, as opposed to age discrimination, causes the "rate of an employee's benefit accrual" to decline with age.[166] According to Defendants,

> [I]t is economically nonsensical to compare a 25 year old employee's rate of benefit accrual with a 64 year old employee's rate of benefit accrual by reference to the age 65 benefit that each has accumulated, because the 64 year old employee is set to receive his benefit much sooner.[167]

For that reason, Defendants argued that the "rate of an employee's benefit accrual" should be measured in terms of "benefits payable immediately upon termination of employment."[168]

According to the *Cooper* court, ERISA creates standing to all plan participants, such as Plaintiffs, "who seek to protect their employee benefit rights."[169] Thus, the court was required to determine the meaning of the term "rate of an employee's benefit accrual."[170] Even though ERISA does not explicitly define this term, the court decided that its meaning must be synonymous with the term "accrued benefit," which is defined in section 203(a) of ERISA as a benefit expressed in terms of an annuity commencing at normal retirement.[171]

In analyzing IBM's pension equity plan, Judge Murphy, who authored the *Cooper* opinion, recognized that employees' benefits expressed in the form

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163. *Id.*
164. *Id.* at 1013.
165. *Id.* at 1016.
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.* at 1014.
170. *Id.* at 1016.
171. *See id.*

of an age sixty-five annuity decrease as employees approach normal retirement age because of the time value of money.[172] He reasoned, "From an economist's perspective, Defendants have a good argument. A dollar today is worth more than the promise of a dollar a year from now. This does not mean, however, that [IBM's pension equity plan] is legal."[173] Judge Murphy determined that Congress chose to use the terms "accrued benefit" and "rate of an employee's benefit accrual" interchangeably because the term "accrued benefit" would not have been grammatically correct if used in section 204(b)(1)(H) of ERISA.[174] Judge Murphy illustrated this point by using an analogy based on the word popcorn. "Popcorn is the word used to describe the product created by exposing corn kernels to extreme heat. If asked to draft a phrase related to the speed of this process, one would not say 'rate of popcorn.' Rather, to be grammatically correct, one would say 'the rate corn pops.'"[175] Because Judge Murphy determined that the terms "rate of an employee's benefit accrual" and "accrued benefit" have identical meanings, the court held that IBM's pension equity plan violated section 204(b)(1)(H) of ERISA.[176]

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172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.* at 1016 n.2.

176. *Id.* at 1017. In addition, the court held that IBM's pension equity plan violated section 204(b)(1)(G) of ERISA because employees' already accrued benefits declined with age. *Id.* at 1014. A pension plan violates section 204(b)(1)(G) "if the participant's accrued benefit is reduced on account of any increase in his age or service." 29 U.S.C. § 1054(b)(1)(G) (2000). Using an example, the court determined that as employees aged, the Benefit Conversion Factor increased, which caused a reduction in their accrued benefit. *Cooper*, 274 F. Supp. 2d at 1015. Defendants argued that Plaintiffs lacked standing to sue because none of the participants actually had their benefit reduced because of age or service. *Id.* at 1014. The language of section 204(b)(1)(G) of ERISA seems to validate Defendants' argument by requiring an actual reduction in the amount of the accrued benefit. 29 U.S.C. § 1054(b)(1)(G) (stating "if the participant's accrued benefit *is reduced* on account of his increase in age or service") (emphasis added); *see IBM's Cash Balance and Pension Equity Formulas Violate ERISA, District Court Rules*, DELOITTE'S WASH. BULL. (Aug. 4, 2003) *at* http://www.benefitslink.com/articles/washbull030804.html [hereinafter Deloitte, *IBM's Cash Balance*]. According to the court, however, the fact that none of the employees actually received a reduction in their accrued benefits may affect the amount of damages awarded but will not relieve Defendants of liability under ERISA. *Cooper*, 274 F. Supp. 2d at 1015.

The court also held that facts unique to IBM's pension equity plan caused it to violate the anti-backloading rules of subsections 204(B)(1)(A), (B), & (C) of ERISA. *Id.* at 1017. The court held that IBM's pension equity plan violated all three of the anti-backloading tests. *Id.* at 1020.

Using the same reasoning applied to IBM's pension equity plan, the court held that IBM's cash balance formula also violated the prohibition against age discrimination under section 204(b)(1)(H) of ERISA.[177] According to Judge Murphy, the "rate of an employee's benefit accrual" under a cash balance plan *must* be determined by converting the pay credits and interest credits into an age sixty-five annuity to determine whether the plan complies with ERISA's requirements.[178] The court determined that, when the benefits of a younger employee and an older employee are compared in terms of an age sixty-five annuity, the interest credits for the younger employee would always be worth more than the interest credits for the older employee.[179] Therefore, the court held that under IBM's cash balance plan, the "rate of an employee's benefit accrual" declined with age in violation of section 204(b)(1)(H) of ERISA.[180]

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177. *Cooper*, 274 F. Supp. 2d at 1021-22.

178. *Id.* at 1021.

179. *Id.*

180. *Id.* at 1022. In past cases, plan participants have also asserted disparate impact claims against employers who have converted their traditional defined benefit formula to a cash balance formula. Some of the Plaintiffs in *Cooper* may have had a possible disparate impact claim against IBM.

In *Godinez v. CBS*, 81 Fed. Appx. 949, 950 (9th Cir. 2003) [hereinafter *Godinez I*], Plaintiffs claimed that they were disproportionately deprived of pension benefits based on their age when CBS Corp. replaced their traditional defined benefit plan with a cash balance pension plan, in violation of ERISA and the ADEA. Godinez v. CBS, No. CV-01-28-GLT, 2002 WL 32155542 at *2 (C.D. Cal. May 20, 2002), *aff'd*, 81 Fed. Appx. 949 (9th Cir. 2003) [hereinafter *Godinez II*]. To prove disparate impact, "an employee bears the burden of showing a facially neutral employment practice had a discriminatory impact on older workers." *Id.*; *see also* Howard Shapiro & Robert Rachal, *Litigation Issues in Cash Balance Plans* (1999), *at* http://www.benefitslink.com/articles/cashbalance.shtml (last visited June 30, 2004). Under the CBS cash balance pension plan, the employees closest to retirement continued to accrue benefits pursuant to CBS's traditional defined benefit plan, as opposed to its cash balance pension plan. *Godinez II*, 2002 WL 32155542 at *1. The pension formula for the youngest employees (age forty-one or younger) was converted to the cash balance formula, which provided an annual benefit equal to 2% of the employee's yearly salary. *Id.* Plaintiffs were members of the middle group of employees, whose pension formulas were converted to the cash balance formula. *Id.* In addition to receiving annual pay credits equal to 2% of their salary, Plaintiffs received Transition Pay Credits ranging from 0.5% to 6.5% of annual eligible pay. *Id.* The U.S. Court of Appeals for the Ninth Circuit upheld the U.S. District Court for the Central District of California's decision that Plaintiffs failed to produce evidence showing any disparate impact on older employees. *Godinez I*, 81 Fed. Appx. at 949. In fact, according to the district court, the CBS pension plan actually treated Plaintiffs better than similarly situated younger employees given that Plaintiffs received transition pay credits based on annual eligible pay that increased yearly. *Godinez II*, 2002 WL 32155542 at *2.

The facts of the IBM case, however, differed significantly from those of the CBS case.

V. Analysis: IBM's Cash Balance Pension Plan and Pension Equity Plan Did Not Discriminate on the Basis of Age

A. The Effect Complained of by the Cooper Plaintiffs Resulted From the Time Value of Money, Not Age Discrimination

Section 204(b)(1)(H) of ERISA, section 411(b)(1)(H) of the IRC, and section 4(i) of the ADEA do not protect against all instances in which an older employee receives a smaller benefit than a younger employee;[181] rather, they only protect against those instances resulting "because of the attainment of any age."[182] In other words, the age discrimination provisions only prohibit a decline in the "rate of an employee's benefit accrual" if it is directly caused by an employee's attainment of a certain age.[183] The interest credit, in the case of IBM's cash balance pension plan, and the increasing Benefit Conversion Factor, in the case of IBM's pension equity plan, caused the alleged age discrimination.[184] Neither the interest credit nor the Benefit Conversion Factor, however, favored the younger workers over the older workers. Instead, both of these features merely protected against inflation, which causes employees' benefits to become less valuable over time.[185] If these features were not part of IBM's pension plans, the younger employees

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When IBM converted its pension equity plan to a cash balance pension plan in 1999, it did not allow many employees to choose between the previous formula and the cash balance formula. *See Cooper*, 274 F. Supp. 2d at 1020. It also appears that IBM failed to provide any transition credits to decrease the adverse effect on older workers. *See id.* As a result of negative reaction from employees, IBM amended its cash balance pension plan in September 1999 to allow additional older employees to choose between the old formula and the cash balance formula. *Id.* Thus, if those employees who were not allowed to remain under the old formula had claimed that the conversion to the cash balance formula caused a disparate impact on them because of their age, they may have had a cause of action against IBM under a disparate impact theory.

181. *See* Lurie, *Age Discrimination*, *supra* note 32, at 304.

182. 26 U.S.C. § 411(b)(1)(H)(i) (2000), 29 U.S.C. § 1054(b)(1)(H)(i) (2000).

183. *See* Lurie, *Age Discrmination*, *supra* note 32, at 304.

184. *Cooper*, 274 F. Supp. 2d at 1012-13. The problems associated with cash balance pension plans reflect the difficulty of applying rules to cash balance pension plans that were developed for traditional defined benefit plans. *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-65. "Many of the basic ERISA concepts . . . work adequately for traditional defined benefit plans, but fail miserably when confronted with non-traditional plans like cash balance plans." *Id.* at 13-56.

185. *See* Shea et al., *supra* note 94, at 775.

would be at a severe disadvantage because their benefits would decline in value over a longer time period than the benefits of the older employees.[186]

Clearly, $1000 today is worth more than $1000 twenty years from now because inflation causes the value of money to decline over time.[187] Assuming everything else is equal, it is clearly not age discrimination for a fifty-year-old and a sixty-year-old to each receive $1000 today.[188] Under a cash balance pension plan, however, for both employees to receive $1000 in present value terms, interest must be added to both of their account balances annually until they receive the pension benefit.[189] Assuming the retirement date under the plan is age sixty-five, a fifty-year-old who works until age sixty-five earns interest on the $1000 for fifteen years, while the sixty-year-old who works until age sixty-five only earns interest for five years.[190] If both the fifty-year-old and the sixty-year-old receive fifteen years worth of interest on the $1000, they would not receive equal benefits.[191] The sixty-year-old would receive greater benefits,[192] and ERISA, in particular, does not require pension plans to favor older employees — it merely requires equality among employees of all ages.[193]

By issuing Notice 96-8[194] and the 1991 nondiscrimination regulations,[195] the IRS and the Treasury Department determined that the correlation between age and the effects of compounding interest does not constitute age discrimination.[196] Indeed, Notice 96-8 *requires* cash balance pension plans to provide frontloaded interest credits under which all interest that will accrue on a pay credit until normal retirement age must be taken into account at the time the pay credit is earned.[197] This IRS requirement, which causes younger employees to receive higher age sixty-five annuities than older employees,[198]

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186. *See* Lurie, *Age Discrimination*, *supra* note 32, at 303; Defendants' Proposed Findings of Fact and Conclusions of Law with Respect to Plaintiffs' Age Discrimination Claims at 5, Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) (No. 99-829).

187. *See* Lurie, *Age Discrimination*, *supra* note 32, at 303; Shea et al., *supra* note 94, at 775.

188. Lurie, *Age Discrimination*, *supra* note 32, at 303.

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. Lunn v. Montgomery Ward & Co., 166 F.3d 880, 883 (7th Cir. 1999).

194. 1996-1 C.B. 359.

195. Treas. Reg. § 1.401(a)(4) (1991).

196. *See* Lurie, *Age Discrimination*, *supra* note 32, at 321-22; *supra* Part III.D.

197. I.R.S. Notice 96-8, 1996-1 C.B. 359, 360.

198. Lurie, *Age Discrimination*, *supra* note 32, at 320-21. This IRS requirement causes younger employees to receive higher age sixty-five annuities than older employees because younger employees receive interest credits over more years than older employees.

is directly contrary to Judge Murphy's analysis. Also, in *Hazen Paper Co. v. Biggins*,[199] the U.S. Supreme Court determined that a pension plan under which the "rate of an employee's benefit accrual" is based on a reasonable factor other than employees' ages will not constitute age discrimination even if the factor strongly correlates with age.[200] Given that the "rate of an employee's benefit accrual" under IBM's pension plans declined because of the effects of compounding interest, the *Cooper* court should not have concluded that these pension plans discriminated on the basis of age.[201]

1. IBM's Cash Balance Pension Plan Did Not Discriminate on the Basis of Age

IBM's cash balance formula treated all similarly situated employees the same, regardless of their respective ages. Each year, employees accrued pay credits equal to five percent of their salary and interest credits at one percentage point higher than the rate of return on one-year Treasury Securities.[202] Hence, under the IBM cash balance pension plan, employees of any age with identical salaries accrued identical benefits, regardless of the difference in their respective ages.[203] Because age was never taken into account in determining the value of employees' benefits, it is difficult to conclude that IBM's cash balance pension plan discriminated on the basis of age.

2. IBM's Pension Equity Plan Did Not Discriminate on the Basis of Age

Under IBM's pension equity plan, the base points and excess points earned each year were determined according to employees' ages and earnings.[204] In actuality, the pension equity plan favored older employees over their younger counterparts because older employees received more points per year of service than younger employees.[205] For example, a thirty-five-year-old employee earned twelve base points and two excess points per year of service, while a forty-five-year-old employee earned sixteen base points and three excess points per year of service.[206]

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199. 507 U.S. 604 (1993).

200. *Id.* at 611.

201. *See Fourth Piece*, *supra* note 4, at 9-11 (noting that interest credits protect cash balance pension plans from inflation and such inflation protectors have never been considered age discriminatory); Shea et al., *supra* note 94, at 774; Shapiro & Rachal, *supra* note 180.

202. Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010, 1013 (S.D. Ill. 2003).

203. *See* Shapiro & Rachal, *supra* note 180.

204. *Cooper*, 274 F. Supp. 2d at 1012.

205. *Id.* at 1023; *see* Defendants' Motion, *supra* note 143, at 4.

206. *Cooper*, 274 F. Supp. 2d at 1023-24; *see* Defendants' Motion, *supra* note 143, at 4.

Furthermore, the Benefit Conversion Factor increased with age only when the "rate of an employee's benefit accrual" was expressed in the form of an age sixty-five annuity. Because the Pension Credit Value was divided by the Benefit Conversion Factor, an increasing Benefit Conversion Factor caused an older employee to receive a lower age sixty-five annuity when compared to a younger employee with an identical salary and the same number of years of service. Even Judge Murphy recognized that under IBM's pension equity plan, "the rate of accrual of an employee's immediately-payable benefit steadily increases with age."[207] When employees' benefits were expressed in the form of an annuity taken immediately upon termination of employment, the Benefit Conversion Factor actually decreased with age,[208] thus causing the "rate of an employee's benefit accrual" to increase with age.[209] Therefore, because "the rate of an employee's benefit accrual" did not decrease in accordance with age, IBM's pension equity plan did not discriminate on the basis of age.

B. ERISA, the IRC, and the ADEA Do Not Define the Phrase "Rate of an Employee's Benefit Accrual" and None of These Statutes Supports the Strict Interpretation Applied by the Cooper Court

ERISA, the IRC, and the ADEA do not explicitly state whether the "rate of an employee's benefit accrual" must be measured in terms of an age sixty-five annuity as opposed to being measured by reference to other terms, such as the annual change in the balance of an employee's hypothetical account. Even Judge Murphy acknowledged that "ERISA does not explicitly answer this question."[210] Because Judge Murphy found section 204(b)(1)(H) of ERISA ambiguous, the legislative history of this statutory provision should have been examined to determine whether Congress intended to use the terms "rate of an employee's benefit accrual" and "accrued benefit" synonymously.[211] Judge

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In addition, according to Defendants' brief, the excess point calculation was also advantageous to older workers because social security compensation is lower for older employees. Defendants' Motion, *supra* note 143, at 5. Thus, the difference between employees' earnings and the social security compensation would have been greater for older employees. *Id.* Consequently, "each excess point [would] produce more dollars of Pension Credit Value for an older employee than for a younger employee if both [had] the same [e]arnings." *Id.*

207. *Cooper*, 274 F. Supp. 2d at 1016 (emphasis omitted).

208. Defendants' Motion, *supra* note 143, at 5.

209. *Cooper*, 274 F. Supp. 2d at 1016.

210. *Id.*

211. Toibb v. Radloff, 501 U.S. 157, 162 (1991) (stating that courts must look to legislative history to determine the meaning of a statute when statutory language is ambiguous); Blum v. Stenson, 465 U.S. 886, 896 (1984) ("Where, as here, resolution of a question of federal law

Murphy, however, not only failed to *analyze* the legislative history of the OBRA age discrimination provisions, he completely *ignored* the legislative history in reaching his conclusion. He also failed to consider the *Eaton v. Onan* decision, in which Judge Hamilton, after providing a detailed opinion outlining the legislative history of the OBRA age discrimination provisions, correctly concluded that cash balance pension plans are not inherently age discriminatory.[212] In fact, Judge Murphy mentioned neither the prior cases in which cash balance pension plans were found to be consistent with the statutory requirements mandated by the OBRA age discrimination provisions, nor any of the guidance issued by the IRS demonstrating its support of the cash balance design.[213] By combining several ERISA sections in a highly questionable fashion, Judge Murphy construed "accrued benefit" and "rate of an employee's benefit accrual" as synonymous.[214] Judge Murphy also contradicted his earlier finding that "ERISA does not explicitly answer this question,"[215] by concluding that the language of section 204(b)(1)(H) of ERISA was "literal and unambiguous."[216]

Contrary to Judge Hamilton's analysis in *Eaton*, Judge Murphy determined that Congress chose to include in ERISA two different terms with the same meaning "to be grammatically correct."[217] After accurately acknowledging that Defendants had a good argument "[f]rom an economist's perspective," and recognizing that the effect complained of by Plaintiffs resulted from the time value of money, Judge Murphy erroneously concluded that Congress chose grammar over sound economical logic.[218] If Congress had intended for the definition of "accrued benefit" to apply to section 204(b)(1)(H) of ERISA, Congress would have worded this section in a grammatically correct way that

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turns on a statute and the intention of Congress, we look first to the statutory language and then to the legislative history if the statutory language is unclear."); Eaton v. Onan, 117 F. Supp. 2d 812, 825 (S.D. Ind. 2000) ("When dealing with such statutory ambiguities, the courts look for guidance from many sources, including legislative history . . . .").

212. *Eaton*, 117 F. Supp. 2d at 825-30.

213. *See generally* Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010 (S.D. Ill. 2003). Ironically, after the court declared IBM's cash balance pension plan age discriminatory, Judge Murphy stated, "IBM, like many other corporate plan sponsors, proceeded with open eyes and was fully informed of the consequences of the litigation that was sure to come." *Id.* at 1022. In light of the previous guidance by the IRS, Treasury Department, and other courts, however, it is difficult to perceive how IBM could have reasonably believed their cash balance pension plan would be declared illegal. Lurie, *Murphy's Law*, *supra* note 138.

214. *Cooper*, 274 F. Supp. 2d at 1016; *see also* Lurie, *Murphy's Law*, *supra* note 138.

215. *Cooper*, 274 F. Supp. 2d at 1016.

216. *Id.* at 1022.

217. *Id.* at 1016.

218. *Id.*

included the term "accrued benefit" instead of the term "rate of an employee's benefit accrual." For example, Congress could have worded section 204(b)(1)(H) as follows: A defined benefit plan will not comply with this provision if the annual change in an employee's "accrued benefit" declines because of the attainment of any age. Or, Congress could have simply defined the term "rate of an employee's benefit accrual" or indicated its intention to use this term interchangeably with the term "accrued benefit." Contrary to Judge Murphy's analysis in *Cooper*, Judge Hamilton determined that Congress did not intend for the two terms to be used synonymously. He concluded, "The argument distinguishing between 'accrued benefit' . . . and 'rate of benefit accrual' may seem like pretty fine hair-splitting. Nevertheless, pension law is a highly technical field where hairs are split with ever finer razors."[219]

As accurately described by the *Eaton* court, the legislative history of OBRA clearly demonstrates that the age discrimination provisions of the IRC, ERISA, and the ADEA were *not intended* to apply to employees younger than normal retirement age.[220] In determining congressional intent for enacting a statute, the conference reports are the most persuasive indicator.[221] The

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219. Eaton v. Onan, 117 F. Supp. 2d 812, 830 n.8 (S.D. Ind. 2000). Also, assuming the age discrimination provisions define the term "rate of an employee's benefit accrual" as an age sixty-five annuity, the U.S. Supreme Court has stated that courts should look to the purpose of a statute if the facial meaning produces absurd results, even if the statute appears unambiguous on its face. City of Columbus v. Ours Garage & Wrecker Serv., Inc., 536 U.S. 424, 449 (2002) ("A statute should not be interpreted to produce absurd results."); Am. Tobacco Co. v. Patterson, 456 U.S. 63, 71 (1982) ("Statutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible."); United States v. Am. Trucking Ass'ns, 310 U.S. 534, 543 (1940) ("When [the plain meaning of the statute] has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act."); *see also* Lurie, *Age Discrimination*, *supra* note 32, at 316; Lurie, *Murphy's Law*, *supra* note 138. Even Judge Murphy recognized that the court's interpretation of the age discrimination statute creates "startling anomalies and absurdities." *Cooper*, 274 F. Supp. 2d at 1020; *see supra* Part V.A; *infra* Part V.D.

220. *See Eaton*, 117 F. Supp. 2d at 829; Rosina B. Barker & Kevin O'Brien, *Cash Balance Conversions Under the ADEA-Reconsidered and Reaffirmed*, 15 BENEFITS LAW J. 1, 13-14 (2002); Shea et al., *supra* note 94, at 768. In addition, the only other courts that have considered this issue have determined that the OBRA age discrimination provisions were not intended to apply to employees younger than normal retirement age. Campbell v. BankBoston, 327 F.3d 1, 10 (1st Cir. 2003); Tootle v. ARINC, Inc., 222 F.R.D. 88, 92-93 (D. Md. 2004); Engers v. AT&T, No. 98-CV-3660, 2002 WL 32159586, at *26-27 (D.N.J. Oct. 17, 2002); *Eaton*, 117 F. Supp. 2d at 829.

221. Garcia v. United States, 469 U.S. 70, 76 (1984) ("In surveying legislative history we have repeatedly stated that the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill."); Resolution Trust Corp. v. Gallagher, 10 F.3d 416, 421 (7th

OBRA Conference Report explicitly demonstrates that Congress enacted the OBRA age discrimination provisions to ensure that employees choosing to work past normal retirement age continued to earn retirement benefits.[222] It states that the age discrimination provisions are "not intended to apply to cases in which a plan satisfies the normal benefit accrual requirements for employees who have not attained normal retirement age."[223] Also, the OBRA Conference Report explains that employees' benefit accruals under any pension plan "may not be reduced or discounted on account of the attainment of *a specified age.*"[224] Before the enactment of the OBRA age discrimination provisions, traditional defined benefit plans "typically stated that an employee was entitled to an accrued benefit equal to a fixed percentage of pay times years of service before age sixty-five and no benefit attributable to years of service after age sixty-five."[225] Therefore, by enacting OBRA, Congress apparently intended to prohibit defined benefit plans from specifying that an employee's benefit accrual would cease to accrue or would begin to accrue at a lower rate once the employee reached normal retirement age.[226] In addition, the plain language of section 411(b)(1)(H) of the IRC and section 204(b)(1)(H) of ERISA supports the proposition that Congress only sought to prohibit accruals from ceasing, or being reduced, at a specified age once the employee reached normal retirement age.[227]

Cir. 1993) (stating that the conference report is "the most persuasive evidence of congressional intent besides the statute itself"); *Eaton*, 117 F. Supp. 2d at 827 ("When the text of a statute is ambiguous, the most persuasive evidence of congressional intent besides the statute itself is the conference report.").

222. H.R. REP. NO. 99-1012, at 378-79 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4024; *see* Eaton, 117 F. Supp. 2d at 829; Shea et al., *supra* note 94, at 768; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-68.

223. H.R. REP. NO. 99-1012, at 378-79, *reprinted in* 1986 U.S.C.C.A.N. at 4024.

224. H.R. REP. NO. 99-1012, at 378, *reprinted in* 1986 U.S.C.C.A.N. at 4023 (emphasis added).

225. Shea et al., *supra* note 94, at 773; *see* Lunn v. Montgomery Ward & Co., 166 F.3d 880, 883 (1999) (recognizing that Montgomery Ward could not say to Lunn, "[I]f you insist on working after you reach the age of 65, [we are] going to cut down your normal retirement benefits").

226. *Eaton*, 117 F. Supp. 2d at 829; Shea et al., *supra* note 94, at 773; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-68; *see supra* Part III.B (explaining the legislative history of the OBRA age discrimination provisions).

227. The plain language of section 411(b)(1)(H) of the IRC and section 204(b)(1)(H) of ERISA prohibits the reduction of "the rate of an employee's benefit accrual . . . because of the *attainment of any age.*" 26 U.S.C. § 411(b)(1)(H)(i) (2000) (emphasis added); 29 U.S.C. § 1054(b)(1)(H)(i) (2000) (emphasis added).

Even if Congress intended for these age discrimination provisions to apply to employees younger than normal retirement age, the term "rate of an employee's benefit accrual" does not necessarily have the same meaning as the term "accrued benefit."[228] If the annual benefit accrual must be converted to an age sixty-five annuity to test for age discrimination, an employee's benefit accrual for each year after normal retirement would appear to decline with age.[229] In fact, most traditional defined benefit plans would fail this test.[230] Furthermore, if Judge Murphy's definition of the term "rate of an employee's benefit accrual" were applied, the example of the pension plan provided in the OBRA Conference Report that complied with the age discrimination provisions[231] would be deemed illegal — a result Congress could not have intended.[232]

C. Public Policy Does Not Favor the Cooper Court's Interpretation of the Age Discrimination Provisions of ERISA

Public policy supports the continued existence of cash balance pension plans for various reasons. First, many employees find cash balance pension plans easier to understand than traditional defined benefit plans because the benefit is expressed in the form of an account balance.[233] In addition, mobile employees, who may not desire to perform services for the same company during their entire careers, are able to change jobs mid-career without foregoing the large benefits that accrue at the end of employees' careers under traditional defined benefit plans.[234] Moreover, cash balance pension plans allow younger employees to accrue benefits earlier in their careers than under traditional defined benefit plans[235] because the benefits accrue more evenly over employees' careers than under traditional plans.[236] Even Judge Murphy

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228. Shea et al., *supra* note 94, at 768.

229. *Id.* at 769.

230. *Id.* at 770.

231. H.R. REP. NO. 99-1012, at 378-79 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4026.

232. *See* Eaton v. Onan, 117 F. Supp. 2d 812, 829 (S.D. Ind. 2000); Shea et al., *supra* note 94, at 769; *see also supra* note 95 and accompanying text.

233. Drigotas, *supra* note 1, at 41; *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-54.

234. *Future of Cash Balance Plans*, *supra* note 42, at 1926. Cash balance pension plans are valuable to women, who are more likely to move in and out of the work force to raise a family. Lawrence J. Sher, *Survey of Cash Balance Pension Plans*, 17 BENEFITS Q. 19, 23 (2001).

235. *Future of Cash Balance Plans*, *supra* note 42, at 1926.

236. Drigotas, *supra* note 1, at 41. In addition, some companies may convert from a traditional defined benefit plan to a cash balance pension plan to save money. Forman & Nixon, *supra* note 4, at 409; Patricia A. Rotello & Thomas A. Osmond, *Part Cash, Part Balancing Act: Why Cash Balance Pension Plans Get So Much Attention*, 14 J. COMPENSATION & BENEFITS 13, 13 (1999). However, it is not always cheaper for a company to convert to a cash balance

recognized that public policy might be advanced if companies implement cash balance pension plans.[237]

If the *Cooper* court's interpretation of ERISA is adopted, employers will be given an incentive not to protect employees' benefits against inflation. The perceived age discrimination complained about by the *Cooper* Plaintiffs resulted from the interest credit, in the case of IBM's cash balance pension plan,[238] and the increasing Benefit Conversion Factor, in the case of IBM's pension equity plan, both of which protected the pension benefit from the effects of inflation.[239] Thus, "if the plan credited no interest on hypothetical allocations, there would be no discrimination."[240] Providing employers with an incentive not to protect the value of an employee's pension benefits is "completely at odds with sound pension policy."[241]

In addition, the *Cooper* court's interpretation of the ERISA age discrimination provisions will cause a significant increase in expenses for employers who maintain cash balance pension plans and pension equity plans.[242] Given that the U.S. pension system is "voluntary,"[243] a significant increase in the cost of maintaining a pension plan will likely cause many companies to abandon their pension plans altogether, a result not supported by public policy considerations. Companies that choose to continue to provide their employees with a pension plan will most likely convert their pension plans to defined contribution plans.[244] The U.S. pension system will "almost certainly migrate to a fully defined contribution plan [and that] move will continue the shift of the investment and saving risk to the individual."[245] Public policy does not favor the shift from cash balance pension plans to defined contribution plans precisely because the pension benefits of workers

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pension plan. Rotello & Osmond, *supra*, at 13-14.

237. Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010, 1022 (S.D. Ill. 2003). Also, the plaintiffs in *Eaton* were unable to state any policy reason that would be advanced by measuring the "rate of an employee's benefit accrual" solely in terms of an age sixty-five annuity. *Eaton*, 117 F. Supp. 2d at 831 n.9.

238. *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-68.

239. Shea et al., *supra* note 94, at 775.

240. *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-68.

241. *Eaton*, 117 F. Supp. 2d at 832.

242. *Firm Seeks Reassurance on Validity of Cash Balance Plan Conversions*, [2000] Tax Notes Today (Tax Analysts) 37-60 (Feb. 24, 2000). Employers would be forced to increase each year's pay credit at the same rate as the interest credit. *Id.* Increasing the annual pay credit as the employee ages, however, may cause cash balance pension plans to violate the anti-backloading rules of ERISA and the IRC. Deloitte, *IBM's Cash Balance*, *supra* note 176.

243. Forman & Nixon, *supra* note 4, at 383.

244. *See Cash Balance Guidance*, PENSIONS & INVESTMENTS, Sept. 1, 2003, at 10.

245. *Id.*

will no longer be guaranteed by the employer. The individual employee, many of whom have limited investment experience, will bear the risk of investment and "[t]hose individuals are much less enthusiastic about defined contribution plans now than at the height of the bull market."[246]

D. Cash Balance Pension Plans and Pension Equity Plans Should Be Measured for Age Discrimination Based on Either the Annual Change in the Hypothetical Account Balance or in Terms of an Annuity Commencing on a Particular Date

As stated above,[247] Congress never defined the phrase "rate of an employee's benefit accrual," which indicates that it did not intend one specific method to be used in determining whether a pension plan complies with the OBRA age discrimination provisions.[248] In addition, section 411(b)(1)(H) of the IRC and section 204(b)(1)(H) of ERISA state: "[A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, *under the plan*, . . . the rate of an employee's benefit accrual is reduced, because of the attainment of any age."[249] The phrase "under the plan" implies that Congress intended to allow the company offering the plan to choose the testing method, thus indicating that various methods were acceptable in proving the plan's compliance with the OBRA age discrimination provisions.[250]

Cash balance pension plans and pension equity plans could reasonably be tested for age discrimination based on the annual change in an employee's hypothetical account balance, which is the same way defined contribution plans[251] are tested.[252] Because defined contribution plans and cash balance

246. *Id.*

247. *See supra* Part V.B.

248. *See* Shea et al., *supra* note 94, at 767.

249. 29 U.S.C. § 1054(b)(1)(H)(i) (2000) (emphasis added).

250. *See* Brief of Amici Curiae, *supra* note 53, at 9. For example, the cash balance pension plan at issue in *Eaton* defined the participant's accrued benefit as either (1) the participant's account balance as of any particular date, or (2) the participant's account balance expressed in the form of an annuity as of any particular date. *Eaton*, 117 F. Supp. 2d at 820. The court determined that both forms reasonably measured whether a cash balance pension plan complied with the OBRA age discrimination provisions. *Id.* at 833.

251. Section 411(b)(2)(A) of the IRC, 26 U.S.C. § 411(b)(2)(A) (2000), prohibits defined contribution plans from causing "the rate at which amounts are allocated to the employee's account" from being reduced "because of the attainment of any age." *Id.*

252. Lurie, *Age Discrimination*, *supra* note 32, at 320; Edward A. Zelinsky, *Is Cross-Testing a Mistake?: Cash Balance Pension Plans, New Comparability Formulas, and the Incoherence of the Nondiscrimination Norm*, [2001] N.Y.U. Rev. of Employee Ben. & Exec. Compensation (MB) 5-1, 5-48 (July 2001) [hereinafter Zelinsky, *Is Cross-Testing a Mistake?*]. A cash balance

plans share many similar features, a reasonable method for determining whether the plan complies with the OBRA age discrimination provisions is to compare the annual change in employees' hypothetical account balances.[253] Also, the regulations issued by the Treasury Department and the IRS in 2002, which were recently withdrawn, stated that "a participant's rate of benefit accrual for a plan year is permitted to be determined as the addition to the participant's hypothetical account for the plan year."[254] Hence, the Treasury Department supports this method of testing.[255] Furthermore, the court in *Eaton v. Onan* concluded that measuring the "rate of an employee's benefit accrual" in terms of the change in an employee's hypothetical account balance was a reasonable method for determining whether a pension plan satisfied the OBRA age discrimination provisions.[256] Additionally, since the *Cooper* opinion was issued, the U.S. District Court for the District of Maryland determined that cash balance pension plans do not discriminate on the basis of age and should be tested for age discrimination by measuring the change in employees' hypothetical account balances over time.[257]

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pension plan could be tested for age discrimination by comparing the annual cost of the benefit. *Simplifying Defined Benefit Plans*, *supra* note 3, at 13-68 n.210.

253. Lurie, *Age Discrimination*, *supra* note 32, at 320; Zelinsky, *Is Cross-Testing a Mistake?*, *supra* note 252, at 5-48. The Treasury Department approved cross-testing, which allows the defined contribution rules to apply to cash balance pension plans, in testing for discrimination in favor of the highly compensated. Treas. Reg. § 1.401(a)(4) (1991); *see* Lurie, *Age Discrimination*, *supra* note 32, at 320. Under the same rationale, cash balance pension plans should be cross-tested for age discrimination. Lurie, *Age Discrimination*, *supra* note 32, at 320.

254. Prop. Treas. Reg. § 1.411(b), 67 Fed. Reg. 76,131 (Dec. 11, 2002).

255. *See supra* note 135 and accompanying text.

256. *Eaton*, 117 F. Supp. 2d at 833.

257. Tootle v. ARINC, Inc., 222 F.R.D. 88, 94 (D. Md. 2004). In *Tootle*, Plaintiff-employee alleged that ARINC's cash balance pension plan discriminated against employees on the basis of age in violation of section 1054(b)(1)(H) of ERISA. *Id.* at 91. Before 1999, ARINC maintained a traditional defined benefit plan that provided employees with benefits based on their years of service and "a percentage of [their] highest three consecutive years of salary within the ten years preceding retirement." *Id.* at 89-90. In January 1999, ARINC converted its traditional defined benefit plan to a cash balance pension plan. *Id.* at 90. ARINC's cash balance pension plan defined each employee's benefit by reference to a hypothetical account balance, which annually accrued a percentage of the employee's salary and an interest credit. *Id.*

According to the U.S. District Court for the District of Maryland, section 1054(b)(1)(H) of ERISA does not apply to employees younger than normal retirement age, based on the legislative history of this section of ERISA and the *Eaton v. Onan* decision. *Id.* at 93. However, even if section 1054(B)(1)(H) of ERISA does apply to employees younger than normal retirement age, the court determined that ERISA does not require that the "rate of an employee's benefit accrual" be measured in terms of an age sixty-five annuity. *Id.* Instead, the

Moreover, cash balance pension plans and pension equity plans could be tested for age discrimination by comparing annuities beginning on a particular date.[258] When the present balance of an employee's hypothetical account is expressed in the form of an annuity, the value of the benefit is greater for older employees when compared with the annuities of their younger counterparts.[259] Also, the *Eaton* court agreed that expressing the "rate of an employee's benefit accrual" in terms of an annuity beginning on any particular date would satisfy the age discrimination rules.[260]

VI. Conclusion

Cash balance pension plans, along with pension equity plans, are not inherently age discriminatory according to the legislative history of the OBRA age discrimination provisions, case law, and guidance from the IRS and Treasury Department. The *Cooper v. IBM Personal Pension Plan* decision defies a strong history of support for cash balance pension plans. Therefore, other courts should not follow the *Cooper* decision.

Allison C. McGrath

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court stated that the "rate of an employee's benefit accrual" should be measured in terms of the change in employees' hypothetical account balances over time, as ERISA requires for defined contribution plans. *Id.* Consequently, the court refused to grant the Plaintiff's motion for class certification and dismissed the Plaintiff's cause of action for failure to state a claim under section 1054(b)(1)(H) of ERISA. *Id.* at 94.

258. *Id.*; Shea et al., *supra* note 94, at 772-73 (noting that benefit accruals could be tested for age discrimination by comparing the value of immediate annuities).

259. *See Eaton*, 117 F. Supp. 2d at 833; Shea et al., *supra* note 94, at 772-73.

260. *Eaton*, 117 F. Supp. 2d at 812. In addition, according to Defendants' brief in *Cooper*, cash balance pension plans and pension equity plans could reasonably be tested for age discrimination by comparing the age sixty-five annuities of employees of different ages, provided that the annuities are discounted to their present value. *See* Defendants' Motion, *supra* note 143, at 10, 13. "'[T]o permit a proper comparison' of annuities payable at different points in time, it is necessary to discount the annuities to present value." *Id.* at 10.