

Spring 2004

## Counting the Cash: Disclosure and Cash Balance Plans, 37 J. Marshall L. Rev. 849 (2004)

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### Recommended Citation

Dana M. Muir, Counting the Cash: Disclosure and Cash Balance Plans, 37 J. Marshall L. Rev. 849 (2004)

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# COUNTING THE CASH: DISCLOSURE AND CASH BALANCE PLANS

DANA M. MUIR\*

**DILBERT**

**BY SCOTT ADAMS**



Over the past few years, numerous employers have converted their traditional pension plans into a new type of plan known as a “cash balance plan.”<sup>2</sup> While that may sound like an esoteric change unlikely to receive much attention from anyone outside the small community of pension actuaries and ERISA lawyers, actual experience indicates otherwise. For example, when the Internal Revenue Service (IRS) held hearings on the regulation of cash balance plans in April 2003, the hearings drew television networks and congressional representatives.<sup>3</sup> Many people and groups wanted to speak so the hearings had to be scheduled in an auditorium over a two-day period, which is hardly the norm for IRS consideration of pension regulation.<sup>4</sup> Further, when IBM announced the conversion of its pension plan in May 1999,<sup>5</sup>

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1. Scott Adams, *Dilbert*, CHI. TRIB., Jan. 23, 2000, at Comics [DILBERT reprinted by permission of United Feature Syndicate, Inc.].

2. See *infra* Part I for a general discussion of conversions. The first cash balance plan conversion occurred in 1985. *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812, 816 (D. Ind. 2000).

3. *The Cash Balance Plan Hearings: A Recap*, 3 EMPLOYEE PLANS NEWS (Internal Revenue Service), Summer 2003, 9 available at <http://www.irs.gov/pub/irs-tege/sum03.pdf> (last visited Mar. 26, 2004).

4. *Id.*

5. INTERNATIONAL BUSINESS MACHINES CORPORATION PROXY STATEMENT FOR THE ANNUAL MEETING OF SHAREHOLDERS 22-23 (Mar. 13, 2000)

affected employees united,<sup>6</sup> sought relief in Congress<sup>7</sup> and brought a shareholder resolution against implementation of the cash balance plan.<sup>8</sup>

Congress has held hearings on the general issue of plan conversions.<sup>9</sup> In 1999, the ERISA Advisory Council studied conversions as one of its major projects.<sup>10</sup> "At least [twenty] percent of the Fortune 1000 companies . . . have converted . . . to a cash balance plan."<sup>11</sup> Now, the major challenges employees face in the workplace, besides small cubicles, incompetent managers and backstabbing fellow employees, include pension plan conversions, as lampooned in the *Dilbert* comic strip.<sup>12</sup>

The underlying source of this controversy is that many of the plan conversions have dilatory effects on some older, long-term employees.<sup>13</sup> Under the original plans, these employees would have seen their pension benefits increase dramatically during

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[hereinafter 2000 IBM PROXY STATEMENT].

6. *Hybrid Pension Plans: Hearings Before the Full Senate Comm. on Health, Education, Labor and Pensions*, 106th Cong. 40 (2000) [hereinafter *Hybrid Pension Plans*] (statement of Janet Krueger, spokesperson for IBM Employee Benefits Action Coalition) (representing group of IBM employees formed in July 1999 to convince IBM to restore pension benefits for 100% of vested employees); 2000 IBM PROXY STATEMENT, *supra* note 5, at 22-23.

7. *Hybrid Pension Plans*, *supra* note 6, at 40 (statement of Janet Krueger).

8. 2000 IBM PROXY STATEMENT, *supra* note 5, at 22-23.

9. *The Cash Balance Conundrum: How to Promote Pensions Without Harming Participants: Hearing Before the Senate Special Comm. on Aging*, 106th Cong. (2000) [hereinafter *The Cash Balance Conundrum*]; *Hybrid Pension Plans*, *supra* note 6; *Hearing on Pension Issues Before the Senate Comm. on Finance*, 106th Cong. (1999).

10. Secretary's Advisory Committee on Employee Welfare and Pension Plans, *Report/Recommendations of the Working Group Studying the Trend in the Defined Benefit Market to Hybrid Plans* (1999) [hereinafter *Advisory Council Report*]. The Advisory Council is established to give advice to the Secretary of Labor on pension and welfare benefit plan issues. Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1142(b) (2000).

11. Colleen T. Congel & Elizabeth A. White, *Prospects for Pension Initiatives Unclear, Movement on Social Security Unlikely*, 27 PENS. & BEN. REP. (BNA) 141 (Jan. 18, 2000). See Michael E. Lichman & Herbert B. Smith, *Implementation, Communications Strategies Essential for Cash Balance Plan Success*, EMPLOYEE BENEFIT PLAN REVIEW, Jan. 2000, at 38 (noting that over 20% of Fortune 500 companies have converted to a CB plan); Daniel Eisenberg, *The Big Pension Swap*, TIME, Apr. 19, 1999, at 36 (stating "[s]ome 20% of FORTUNE 500 companies, including AT&T and Xerox, now offer [CB] plans"); Bernard Sanders, *IBM Workers Fight Back*, THE NATION, Jan. 24, 2000, at 7 (stating "[twenty] percent of Fortune 500 companies and more than 300 companies in all have slashed the retirement benefits that they promised their employees" by converting to a CB plan).

12. Adams, *supra* note 1, at Comics.

13. See *infra* notes 64-71 and accompanying text (discussing the concept of "wearaway," and how older employees are disadvantaged by switching to CB plans).

their last few years of employment.<sup>14</sup> Instead, the new plans often have the effect of either temporarily freezing the benefits of the older employees, or at the very least, causing them to be worse off at retirement than they would have been under the original plan.<sup>15</sup> In contrast, younger workers see their benefits increase more rapidly under the new plans than they would have under the original plans.<sup>16</sup> As a result, some detractors allege that the conversions violate the Age Discrimination in Employment Act of 1974 (ADEA).<sup>17</sup> Others argue that the conversions violate provisions of the Internal Revenue Code (IRC),<sup>18</sup> or the Employee Retirement Income Security Act of 1974 (ERISA).<sup>19</sup> Beyond the legal arguments, opponents attack conversions as unfairly repudiating the implicit compensation contract between employers and employees.<sup>20</sup>

From the perspective of employers, the new plans help them recruit and retain employees in the tight labor market that existed when the trend to cash balance plans began.<sup>21</sup> The plans probably decreased employers' benefit costs during the recent economic decline.<sup>22</sup> Some employers believe that employees better understand the new plans and place a higher value on them than on equally costly old-style plans.<sup>23</sup> This is in part because of regulation on how employers could fund the old-style plans; employers with aging workforces now are facing dramatically increasing plan costs.<sup>24</sup> By making the change to cash balance

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14. See *infra* note 63 and accompanying text (concluding that demographic changes may have led to increased conversion to CB plans).

15. See *infra* notes 68-71 and accompanying text (explaining why the plan conversions have this effect).

16. See *infra* notes 61-63 and accompanying text (discussing the effect of demographic changes on pension plan conversions).

17. 29 U.S.C. §§ 621-634 (2000). For a brief discussion of the age discrimination issues, see *infra* Part II.A.1..

18. For a discussion of the IRC issues, see *infra* notes 198-201 and accompanying text.

19. 29 U.S.C. §§ 1001-1461. For a discussion of the ERISA issues, see *infra* Part II.A.2.

20. See *infra* Part II.B (discussing ethical challenges to CB plan conversions).

21. See *infra* Part I.B.1 (discussing practical motivations for CB plan conversions).

22. PATRICK J. PURCELL, PENSION ISSUES: CASH BALANCE PLANS 5 (CRS Report for Congress 2003), available at <http://www.pensionrights.org/docs/RL30196.pdf> (last visited Mar. 29, 2004).

23. See *infra* note 56 and accompanying text (discussing factors employers reported for plan conversions).

24. *Pensions in Crisis*, WATSON WYATT INSIDER, Sept. 2003, at <http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=11813&Component=The+Insider> (last visited Mar. 23, 2004). See *infra* notes 81-85 and accompanying text (discussing impact of the Omnibus Budget Reconciliation Act on pension plans).

plans, those employers may be able to decrease their current funding obligations, thereby avoiding a drag on corporate performance.<sup>25</sup>

Opponents of cash balance plans are likely to continue their fight for substantive regulation to limit the effect of plan conversions.<sup>26</sup> In contrast, many legislative proposals intended to address the perceived problems of cash balance plans,<sup>27</sup> including the only enacted legislation on point,<sup>28</sup> have focused primarily on increasing the disclosure requirements associated with plan conversions. After its in-depth study, the ERISA Advisory Council advocated increased disclosure rather than substantive regulation.<sup>29</sup>

The existing literature on conversions to cash balance plans focuses on their legality,<sup>30</sup> and as a result fails to address the

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25. Vineeta Anand, *Full Disclosure; Lawmakers Ask: Where's Income?*, PENSIONS & INV., July 24, 2000, at 1 [hereinafter Anand, *Full Disclosure*] (stating "IBM . . . reported \$638 million in pension income at the end of 1999, or 5.3% of its operating income"). See also Vineeta Anand, *Bottom Line: Pension Funds Become Profit Center*, PENSIONS & INV., July 26, 2000, at 1 (discussing studies indicating that "pension funds might have morphed into profit centers from cost centers at many of the nation's largest companies").

26. See *The Cash Balance Conundrum*, *supra* note 9, at 30-50 (statement of Karen Ferguson, Director of The Pension Rights Center) (arguing substantive regulation on cash balance conversions should include three components: (1) employee option to be grand fathered in original plan, (2) protection of employees' reasonable expectations, and (3) taxation of conversions that fail to comply with item (1) or (2)); *id.* at 8-29 (statement of Joseph Perkins, former president America Association of Retired Persons) (proposing that (1) employees have choice of plans or be grand fathered in original plan, and (2) plans be prohibited from 'freezing' benefit accruals for older employees); *Statement by AARP Director of Federal Affairs David Certner in Support of the Sanders-Miller Cash Balance Pension Legislation*, Apr. 8, 2003, at <http://www.aarp.org/research/press/presscurrent/news/cn-2003/Articles/a2003-08-18-pensionlegislation.html> (last visited Mar. 26, 2004).

27. Pension Right to Know Act, H.R. 1176/S. 659, 106th Cong. § 2 (1999); The Comprehensive Retirement Security and Pension Reform Act of 1999, H.R. 1102, 106th Cong. § 407 (1999); Pension Reduction Disclosure Act, H.R. 3047/S. 1708, 106th Cong. §§ 2-4 (1999). *But see* Older Workers Pension Protection Act of 1999, H.R. 2759/S. 1600, 106th Cong. (1999) (imposing substantive requirements as well as increased disclosure); Pension Benefits Protection and Preservation Act of 1999, H.R. 2902/S. 1640, 106th Cong. (1999) (imposing substantive requirements as well as increased disclosure).

28. Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, § 659, 115 Stat. 70 (2001).

29. *Advisory Council Report*, *supra* note 10.

30. See, e.g., *The Future of Private Pensions: Proceedings of the 2001 Annual Meeting of the Association of American Law Schools, Section on Employee Benefits*, 5 EMPL. RTS. & EMP. POL'Y J. 351, 355 (2001) [hereinafter *The Future of Private Pensions*] (presentation by Jonathan B. Forman) (noting that routine CB conversions generally do not violate pension or age discrimination laws); *id.* at 366 (presentation by Norman P. Stein) (discussing

policy and legislative interest in enhancing the disclosure requirements imposed on employers who implement plan conversions. This article develops a theoretical voting model to assess the expected effect that increased information would have on the rate and terms of plan conversions. For those who are unfamiliar with the phenomena Part I will provide background on the conversions of defined benefit plans to cash balance plans. Part II will examine the legal and ethical issues raised by plan conversions. Part III will evaluate the rationales for requiring increased disclosure. If the goal of providing increased information is to effect change, that change could occur on a group level, an individual level, or a relational level. However, only a group level effect would have an impact on the rate and terms of cash balance plan conversions. In Part IV, a voting model is developed to analyze the expected effect of additional disclosure requirements. The modeling predicts that increased disclosure is unlikely to have any effect on cash balance plan conversion decision making. Therefore, the only way to predictably affect the rate and terms of cash balance plan conversions is to substantively regulate them. Based upon this insight, Part V discusses the cost burdens that are associated with substantive regulation of conversions to cash balance plans and considers the effect of those burdens. Ironically, it will find that substantive regulation may actually increase the costs borne by older workers.

## I. BACKGROUND ON CASH BALANCE PLAN CONVERSIONS

This section begins by examining cash balance plans and how they differ from traditional pension plans. It will then explain why employers choose to convert to cash balance plans. It will end by discussing an analogous trend of plan changes, which occurred during the 1980s.

### A. Plan Typology

Until 1997, the most common employer-sponsored retirement plan in the United States was a defined benefit (DB) plan.<sup>31</sup> DB plans promise benefits based on a formula, which often has years of service and employee salary as key components.<sup>32</sup> For example,

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problems raised by CB plans because of the existing regulatory structure); Regina T. Jefferson, *Striking a Balance in the Cash Balance Plan Debate*, 49 BUFF. L. REV. 513, 562 (2001) (suggesting that changes in pension laws could resolve problems with CB plan conversions); Edward A. Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX REV. 683, 761 (2000) (recommending changes in statutory regulations to resolve the CB controversy).

31. PENSION BENEFIT GUARANTY CORPORATION, PENSION INSURANCE DATA BOOK 1998, at 8 fig. 7 (1999) [hereinafter DATA BOOK] (showing that TDB plans have traditionally been the provider of primary pension coverage).

32. MICHAEL J. CANAN, QUALIFIED RETIREMENT PLANS § 3.51 (2004 ed.

a DB plan might provide for benefits at age sixty-five of 1.5% per year of service multiplied by the employee's salary averaged over the final five years of employment. At retirement, an employee with thirty years of service and a final average salary of \$50,000 per year would be entitled to an age sixty-five pension benefit of \$22,500 per year.<sup>33</sup> Since most DB plans pay benefits in the form of an annuity, thus, the retiree receives lifetime monthly benefits.<sup>34</sup> Many DB plans also provide early retirement incentives once employees reach an age and service threshold, such as age fifty-five and twenty years of service.<sup>35</sup>

In a DB plan, the employer bears the first tier of risk because regardless of the performance of the plan's investments, the employer must fund the plan sufficiently to provide the promised benefits.<sup>36</sup>

The Pension Benefit Guaranty Corporation ("PBGC"), which is funded with premiums paid by DB plan sponsors, bears the second tier of risk because it guarantees payment of certain plan benefits in case the employer defaults.<sup>37</sup> This article refers to these traditional DB plans as TDB plans.

A second type of plan, known as a defined contribution ("DC") plan, consists of individualized plan accounts established on behalf of each participating employee.<sup>38</sup> The employee's ultimate benefit is the value of her account—the sum of all contributions and investment gains and losses.<sup>39</sup> Thus, the investment risk is on the employee. Employers can avoid liability for investment decisions by delegating investment choices to individual participants.<sup>40</sup> Under a DC plan because of the way benefits are calculated the plan's assets always equal its liabilities; therefore, they are not insured by the PBGC.<sup>41</sup> DC plans typically permit the payment of benefits to be made in the form of a lump sum.<sup>42</sup> All pension plans

2003).

33.  $(1.5\% \times 30 \text{ years of service}) \times \$50,000 \text{ final average salary} = \$22,500$ .

34. CANAN, *supra* note 32, § 3.52. Participants' spouses also have rights in determining the form of payment of DB plan benefits. *Id.* § 7.16.

35. DAN M. MCGILL & DONALD S. GRUBBS, JR., *FUNDAMENTALS OF PRIVATE PENSIONS* 131 (6th ed. 1989).

36. I.R.C. § 412 (2000). See CANAN, *supra* note 32, §§ 12.1-12.9 (providing a thorough review of minimum funding standards).

37. DATA BOOK, *supra* note 31, at 1.

38. CANAN, *supra* note 32, § 3.11.

39. *Id.*

40. KPMG, *RETIREMENT BENEFITS IN THE 1990S: 1997 SURVEY DATA* 35-36 (1997).

41. *But see* Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 681-82 (2000) (advocating the establishment of an insurance program to protect a minimum investment return on DC plan accounts).

42. AMERICAN ACADEMY OF ACTUARIES, *FINANCING THE RETIREMENT OF FUTURE GENERATIONS* 14 (1998), at

are either DB or DC plans.

Since the early 1980s, the number of DC plans has exploded.<sup>43</sup> Perhaps the most significant event contributing to their popularity occurred in 1981 when the Treasury Department issued regulations establishing the boundaries of what have come to be known as “401(k) plans.”<sup>44</sup> These plans typically permit employees to set aside part of their salary as retirement savings and decide how to invest the funds.<sup>45</sup> Many employers also match some portion of the employees’ contributions, thereby encouraging plan participation.<sup>46</sup> Although no 401(k) plans existed in 1979, by 2000 forty-six percent of all workers at firms with 100 or more employees were entitled to participate in DC plans, such as 401(k) plans.<sup>47</sup> Most new employers choose to offer a DC plan rather than a DB plan.<sup>48</sup> The majority of growth in pension plans since the 1970s has occurred in DC plans.<sup>49</sup>

Cash balance (“CB”) plans intersect the boundaries of TDB and DC plans. Because of this duality, which is inherent in their structure, CB plans are frequently referred to as hybrid plans.<sup>50</sup>

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<http://www.actuary.org/pdf/pension/retirement.pdf> (last visited Mar. 2, 2004).

43. *Id.* at 12-13. See WORKING GROUP ON THE MERITS OF DEFINED CONTRIBUTION VS. DEFINED BENEFIT PLANS WITH AN EMPHASIS ON SMALL BUSINESS CONCERNS 1 (Dep’t of Labor, ERISA Advisory Council 1997) [hereinafter ERISA ADVISORY REPORT ON DC VS. DB PLANS] (noting the movement from DB plans to DC plans).

44. JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 50 (2d ed. 1995).

45. *Id.* at 49-50

46. *Id.* at 50.

47. Purcell, *supra* note 22, at CRS-1 table 1.

48. *Hearing Before the Subcommittee on Employer-Employee Relations Before the House Education and the Workforce Subcommittee*, 106th Cong. 5 (2000) (statement of Leslie B. Kramerich, Acting Assistant Sec’y, Pension and Welfare Benefits Admin. U.S. Dep’t of Labor) (stating “[t]he most significant trend in the employment-based private pension system has been the increasing significance of defined contribution plans. The number of participants in these plans has grown from fewer than 12 million in 1975 to 40 million in 1998”).

49. UNITED STATES GENERAL ACCOUNTING OFFICE, PRIVATE PENSIONS: IMPROVING WORKER COVERAGE AND BENEFITS 7 fig. 1 (Apr. 2002), available at <http://www.gao.gov/new.items/d02225.pdf> (last visited Mar. 2, 2004). See UNITED STATES GENERAL ACCOUNTING OFFICE, PRIVATE PENSIONS: MOST EMPLOYERS THAT OFFER PENSIONS USE DEFINED CONTRIBUTION PLANS 2 (1996), available at <http://www.gao.gov/archive/1997/gg97001.pdf> (last visited Mar. 2, 2004) (finding that between 1984 and 1993, of those employers that sponsored pension plans, the percentage that offered only a DC plan had increased from 68% to 88%).

50. KYLE N. BROWN ET AL., THE UNFOLDING OF A PREDICTABLE SURPRISE: A COMPREHENSIVE ANALYSIS OF THE SHIFT FROM TRADITIONAL PENSIONS TO HYBRID PLANS 1 (2000), available at <http://www.watsonwyatt.com/research/deliverpdf.asp?catalog=W-326&id=x.pdf> (last visited Mar. 2, 2004) (referring to CB and pension equity plans as “hybrid defined benefit plans”); *Advisory Council*



As a technical matter, CB plans are a subset of DB plans because they promise participants a benefit based on a formula and do not provide actual individual accounts for plan participants.<sup>51</sup> CB plans look very much like DC plans because the promised benefit tends to be based on the same two components as the typical DC plan.

One component, the "pay component," is typically in the form of an annual contribution equaling a percentage of the participant's compensation.<sup>52</sup> The second component, the "investment component," provides for an investment return based on a defined rate.<sup>53</sup> The investment component may be either a fixed rate or it may correspond to well-known rates, such as those identified on U.S. Treasury instruments.<sup>54</sup>

Thus, CB plan benefits are communicated to employees as a series of individual entitlements based on pay and investment return components, as in DC plans. The difference, however, is that individual plan accounts are strictly hypothetical in a CB plan. No actual employee accounts are established and the plan captures any positive difference between the promised investment return and the actual return. On the other hand, as with a DB plan, the first tier of investment risk remains on employers because they must fund the plan sufficiently to pay promised benefits, and make up any difference if the promised investment returns exceed the actual investment returns. Since CB plans are a species of DB plans and make commitments of specific benefits to participants, the PBGC insures them providing a second tier of protection. CB plans typically provide for the payment of benefits in the form of either an annuity or a lump sum at the option of the benefit recipients.<sup>55</sup>

### *B. Employer Conversions to Cash Balance Plans*

This section will detail the factors leading employers to convert their established TDB plans to CB plans. It begins by examining the motivations as reported by the employers

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*Report, supra* note 9 (referring to "Cash Balance and Other Hybrid Plans").

51. I.R.S. Notice 96-8, 1996-1 C.B. 359, \*1 (stating that "a cash balance plan is a defined benefit pension plan"); CANAN, *supra* note 32, § 3.52[E].

52. CANAN, *supra* note 32, § 3.52[E].

53. *Id.*

54. *Advisory Council Report, supra* note 10.

55. See I.R.S. Notice 96-8, 1996-1 C.B. 359, \*2 (stating that "[m]ost cash balance plans also are designed to permit, after termination of employment, a distribution of an employee's entire accrued benefit in the form of a single sum distribution equal to the employee's hypothetical account balance as of the date of the distribution"); *Advisory Council Report, supra* note 9 (explaining that CB plan benefits "are presumptively payable as an annuity"); BROWN, *supra* note 50, at 3 (indicating that CB plans "frequently offer[ ] the lump sum as a primary form of benefit distribution").

themselves. Next, it discusses the effect that demographic changes in the workforce may have on plan sponsorship. Finally, it concludes with an analysis of the role played by pension plan funding regulations and plan costs.

### 1. *Reported Motivations for Plan Conversions*

A prominent survey, summarized in Table 1, inquired into the primary motivations reported by employers who switched from a TDB to a CB plan. The top three factors all reflect employer frustration based on the long-held belief that employees tend not to understand or properly value their employee benefit plans, particularly pension plans.<sup>56</sup> According to the survey, employers believe that: (a) lump sum values are easier to communicate to employees than annuity values; (b) employees understand large lump sum balances better than they understand the value of a future annuity stream; and (c) employees place a higher value on lump sum balances than on annuity streams.<sup>57</sup>

**Table 1: Top Four Factors Identified as Important by Employers Who Have Undertaken Plan Conversions**

<i>Factors</i>	<i>Percentage of All Respondents</i>
Improves employees' appreciation of plan	96.0
Facilitates communications	93.0
Ability to show lump sum values	93.0
Aids in recruitment	80.8 <sup>58</sup>

Logically, the fourth factor, "aids in recruitment," also relates to the perceived differential between employees' understanding and valuation of CB plans as compared to TDB plans. Assume that an employer would incur equal costs in sponsoring either Plan X, a TDB plan, or Plan Y, a CB plan.<sup>59</sup> If, because of the first three factors listed in the survey, a recruit places a higher value on the benefits provided by Plan Y than those provided by Plan X, then the potential employer has reason to prefer Plan Y.

However, the alternatives to CB plans give rise to some

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56. BROWN, *supra* note 50, at 44.

57. *Id.*

58. *Id.* at 44 table 19.

59. See *infra* notes 89-95 and accompanying text (discussing the data on how conversions from TDB to CB plans affect plan costs).

skepticism as to whether employers are accurately reporting their motivations for plan conversions. One reason employers give to support their plan conversions is that employees prefer or better understand lump sum account balances as compared to annuities. However, nothing prevents a TDB plan from calculating the current value of a participant's accrued annuity benefit and reporting the value to the participant as part of the normal benefit statements.<sup>60</sup> Surely, such an addition to the plan's disclosure statements would be a simpler way to address the perceived problem than to undertake a complete restructuring of the plan, which is what a CB conversion requires. Similarly, any TDB plan can provide terminating employees with the option of receiving a lump sum distribution.<sup>61</sup>

## 2. *The Effect of Demographic Changes in the U.S. Workforce*

Whether viewed as subtext in the concerns that employers report with recruitment,<sup>62</sup> or through a more skeptical lens, indications point to the demography of today's workforce as a factor in the rate of CB plan conversions. Due to the nature of the TDB plan benefit formula, which considers both years of service and final average salary, a significant portion of an employee's benefits tends to be accrued in the final years of employment.<sup>63</sup> In contrast, employees accrue CB plan assets more evenly over their entire working career. Therefore, employees earn higher benefits at younger ages in a CB plan as compared to a TDB plan.

In fact, some data indicate that the difference is so significant that CB plans may actually reverse the traditional pattern of earning retirement benefits. According to preliminary data gathered by the Equal Employment Opportunity Commission (EEOC), a thirty-year employee will earn approximately fifty percent of her total retirement benefit in her final ten to twelve years of work in a TDB plan.<sup>64</sup> In contrast, under a CB plan, an employee with thirty years of service would only accrue approximately twenty percent of his total retirement benefit during his last ten to twelve years of work.<sup>65</sup> The CB employee

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60. Zelinsky, *supra* note 30, at 707-09.

61. *See id.* (noting the redistribution of benefits under the two approaches). *See also* CANAN, *supra* note 32, § 7.16 (noting election of the lump sum option may require spousal consent).

62. *See supra* note 58 and accompanying table (describing selected employer motivations to shift to hybrid plans).

63. *See* Colleen T. Congel, *EEOC Director Offers Preliminary Data on Cash Balance Age Discrimination Review*, 27 PENS. & BEN. REP. (BNA) 1333 (2000) (discussing a letter from the EEOC chairwoman to Senator Charles E. Grassley noting the detrimental impact to older workers in cash balance conversions).

64. *Id.*

65. *Id.*

would accrue approximately fifty percent of his benefit during his first twelve years of employment.<sup>66</sup>

This reversal in the pattern of accruals illustrates one way in which older employees are disadvantaged by a CB plan conversion. Older employees who are still working at the time of the conversion worked for a relatively low rate of pension accruals under the TDB plan when they were young. They expected, based on the terms of the plan, to earn dramatically higher rates of accruals during their later years of employment. In the absence of any mitigating provisions, when an employer converts to a CB plan, those older workers get the worst of both plans. They earned the low accrual rates under the traditional plan during their early working years and they complete their job tenure by earning the lower rate of accruals under the CB plan.<sup>67</sup>

Some plan conversions also decrease benefits for older employees through a mechanism known as a "wearaway." When an employer converts its plan to a CB plan, depending on the assumptions used, older employees may have initial balances in the CB plan that are lower than their existing benefit under the TDB plan. Since ERISA prohibits plans from decreasing vested accrued benefits, the employees' existing benefits cannot actually be decreased. However, some plan conversions, in effect, freeze the employees' benefits until the employee works long enough to 'wearaway' the difference between the TDB plan benefit and the CB plan benefit. For example, assume the current value on the date of plan conversion of a fifty-five year old employee's TDB plan benefit is \$87,582 and the current value of the new CB plan benefit is \$66,677.<sup>68</sup> That employee has a wearaway of \$20,905.<sup>69</sup> Given reasonable assumptions, the employee will need to work more than eight years before the employee's pension benefit increases above the \$87,582 she earned under the traditional plan as of the date of conversion.<sup>70</sup>

The third way in which a conversion to a CB plan may disadvantage older, long-service workers is by eliminating

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66. *Id.*

67. *Id.* See *The Cash Balance Conundrum*, *supra* note 9, at 1 (statement of Karen Ferguson, Director of The Pension Rights Center) (noting that plan conversions deprive older employees of expected accrual rates).

68. *The Cash Balance Conundrum*, *supra* note 9, at 8 (statement of Joseph Perkins, former President the American Association of Retired Persons).

69. *Id.*

70. *Id.* The example assumes annual compensation of \$40,000, age sixty-two as the normal retirement age, a 5% annual pay credit, annual salary increases of 5%, both an interest rate and a discount rate of 6%, and GATT mortality tables. *Id.* See Jonathan Barry Forman & Amy Nixon, *Cash Balance Pension Plan Conversions*, 25 OKLA. CITY U. L. REV. 379, 403-05 (2000) (providing a more detailed discussion of the causes and possible effects of wearaways).

subsidized early retirement benefits. As in the foregoing examples, employees who are on the verge of becoming entitled to subsidized early retirements, usually by reaching age and service thresholds, will experience a substantial blow to their retirement income expectations if those benefits are eliminated.<sup>71</sup> When combined with decreased accrual rates and the possibility of wearaways, the effect of the loss of anticipated early retirement benefits becomes magnified. Thus, depending on the plan conversion and the particular circumstances of individual employees, any or all three of these factors might contribute to what an individual perceives as a loss of expected benefits.

None of the dilatory effects just discussed—decreased rates of accruals, wearaways and elimination of subsidized early retirement benefits—are necessary results of CB plan conversions. Employers can choose to structure plan conversions in ways that protect the expectations of older employees.<sup>72</sup> Kodak is frequently cited as an employer that fully protected all of the participants in its TDB plan from any negative effects when it converted to a CB plan.<sup>73</sup> IBM after facing strong levels of employee dissent, unionizing efforts and negative publicity, just before a scheduled Senate hearing on the issue, gave all its employees over age forty who had at least ten years of IBM service at the time of the conversion the option of choosing between the traditional plan and the revised plan.<sup>74</sup> Still, some IBM employees who were under age forty, or were employed for less than ten years at IBM as of the date of the plan conversion, expect to receive lower pension benefits under the CB plan than they would have earned under the traditional plan.<sup>75</sup> Numerous other employers elected not to grandfather older workers at the time of plan conversion.<sup>76</sup>

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71. Zelinsky, *supra* note 30, at 699-702. ERISA and the IRC both impose some limit on the extent to which employers may defeat early retirement expectations. ERISA § 204(g), 29 U.S.C. § 1054(g) (2000); I.R.C. § 411(d)(6) (2000). See LANGBEIN & WOLK, *supra* note 44, at 142-44 (discussing ERISA amendments limiting an employer's ability to eliminate or redress certain retirement benefits).

72. Zelinsky, *supra* note 30, at 697-99.

73. Norman Stein, *Some Serious Questions About Cash Balance Plans*, CONTINGENCIES, Sept./Oct. 1999, at 28, 32.

74. Letter from Daniel E. O'Donnell, Vice President and Secretary, IBM, to IBM Stockholders 4 (Apr. 11, 2000) (available in SEC's EDGAR database as IBM's Definitive Proxy Statement, filed Apr. 11, 2000).

75. *Id.* See *Hybrid Pension Plans*, *supra* note 6, at 40 (1999) (statement of Janet Krueger, spokesperson for IBM Employee Benefits Action Coalition) (representing group of IBM employees formed in July 1999 to convince IBM to restore pension benefits for 100% of vested employees).

76. *The Cash Balance Conundrum*, *supra* note 9, at 3 (statement of James A. Bruggeman, Employee of Central and South West Corporation) (explaining that he lost approximately 30% of the value of his expected pension as a result of the company's conversion to a CB plan); Lee A. Sheppard, *The Down-Aging*

CB plans tend to be more attractive than TDB plans to younger workers with relatively short job tenures because of the difference in accrual patterns and payment options. In the era when large corporations worked to reduce workforce turnover, and the employer and employees ideally sought lifetime employment, large employers tended to sponsor TDB plans.<sup>77</sup> By heavily weighing benefits accrual towards older, long-term employees, TDB plans supported the goal of long-term employment.<sup>78</sup> However, changing employment patterns and nontraditional work arrangements make TDB plans less attractive to employers. Instead, for educated, technically skilled employees who have shorter-term job expectations, CB plans are more efficient than TDB plans in providing benefits to that group of workers.

Two characteristics make CB plans more attractive than TDB plans to certain workers. First, younger workers accumulate benefits more quickly under CB plans than they could under TDB plans. Second, the lump sum benefit option typically provided by CB plans makes those benefits more portable than the annuity-style benefits normally provided by TDB plans. To the extent that an employer with an existing TDB plan wants to maximize the attractiveness of its plan to younger, mobile workers, it would be reasonable for it to convert to a CB plan.<sup>79</sup>

### 3. *The Influence of Plan Funding Regulation and Plan Costs*

The demographic changes that are occurring as the U.S. workforce ages can dramatically increase the costs of a TDB plan. ERISA imposes both minimum and maximum funding standards on pension plan sponsors.<sup>80</sup> The Omnibus Budget Reconciliation Act of 1987<sup>81</sup> decreased employers' flexibility in pre-funding their pension plans by mandating that an employer could only make tax-deductible contributions until its plan became funded at between 150 and 170% of current liability.<sup>82</sup> Essentially, this

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*of Pension Plans*, 82 TAX NOTES 171, 173 (Jan. 11, 1999) (referring to Bank of America's plan conversion).

77. The number of defined benefit plans peaked in 1985 at approximately 112,000.

78. Peter T. Scott, *A National Retirement Income Policy*, 44 TAX NOTES 913, 919 (1989).

79. Changing from a TDB to a DC plan would accomplish many of the same goals, but would be subject to significant tax penalties. See *infra* notes 237-241 and accompanying text.

80. 29 U.S.C. §§ 1081-1086 (2000); I.R.C. § 412 (2000).

81. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 9303, 101 Stat. 1330-33 (codified as amended at I.R.C. § 412).

82. *ERISA Advisory Report on DC vs. DB Plans*, *supra* note 43, at 8-9. See Regina T. Jefferson, *Defined Benefit Plan Funding: How Much is Too Much?*, 44 CASE W. RES. 1 (1993) (discussing private pension plan funding rules). EGTRRA phased in more flexibility for employer contributions, but sunsets in 2010. EGTRRA §§ 651-652.

limitation only permitted a TDB plan's obligations to be calculated on workers' current salaries and job tenures.<sup>83</sup> Thus, it slowed funding for the benefits of the baby boom generation, who were between the ages of twenty-three and forty-one when the legislation was enacted.<sup>84</sup> In addition, because plan-funding obligations were recalculated according to the new limitations, many plans had assets in excess of the funding limitations.<sup>85</sup> Plan sponsors, therefore, were precluded from making additional tax-deductible contributions.

As the substantial set of baby boom workers approach retirement age under a TDB plan, the funding obligation increases rapidly, reflecting the estimate that workers earn approximately fifty percent of their benefits during their final ten to twelve years of employment.<sup>86</sup> The data on the relationship between funding issues and plan conversions are somewhat inconsistent. More than sixty percent of those employers who have converted to a CB plan report that stability and management of plan expenses was a factor in the conversion decision.<sup>87</sup> One data study comparing funding status with plan conversions found only a weak relationship between the funding patterns and conversions.<sup>88</sup>

However, looking only at those plans that have converted, funding status of the prior TDB plan does appear relevant. The ERISA Advisory Council estimated that approximately 95% of the existing CB plans were established through the conversion of overfunded TDB plans.<sup>89</sup>

Similarly, some opponents of CB plans allege that employers engage in plan conversions to decrease pension plan costs.<sup>90</sup> Anecdotally, one litigated case supports this allegation because the employer began its assessment of its DB plan options and ultimately converted to a CB plan after learning that legislative changes would cause its plan expenses to increase between \$750,000 and \$2,000,000 in the first year alone.<sup>91</sup> The data from a detailed conversions study illustrates some of the difficulties in

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83. Jefferson, *supra* note 82, at 13-14.

84. BROWN, *supra* note 50, at 12.

85. *Id.*; ERISA Advisory Report on DC vs. DB Plans, *supra* note 43, at 8.

86. See *supra* note 64 and accompanying text (citing EEOC data on heavy back end accrual of retirement benefits).

87. BROWN, *supra* note 50, at 45. See *Hybrid Pension Plans*, *supra* note 6, at 151-62 (statement of Jack VanDerhei, Temple University and Fellow, Employee Benefit Research Institute) (listing additional funding flexibility as one of the positive attributes of a CB plan).

88. BROWN, *supra* note 50, at 14-15.

89. Advisory Council Report, *supra* note 10.

90. *The Cash Balance Conundrum*, *supra* note 9, at 9 (statement of Joseph, former President of the American Association of Retired Persons); Sheppard, *supra* note 76, at 171; Zelinsky, *supra* note 30, at 705-07, 709-15.

91. *Eaton*, 117 F. Supp. 2d at 819.

evaluating the extent to which cost savings is an important factor in conversion decisions. The study found that conversions do tend to reduce costs in the converted plan.<sup>92</sup> The same study found that many employers who convert to a CB plan either establish or enhance a DC plan.<sup>93</sup> As a result, the survey predicted that the total impact of plan conversions on pension plan costs will "be so negligible in aggregate that the shift in plan designs overall can be characterized as cost-neutral."<sup>94</sup> Even when an employer maintains plan expenses at the same level after a conversion, the typical accrual pattern means that the change to a CB plan will shift benefits from older to younger workers.<sup>95</sup>

Thus, the effect of a plan conversion decreases the pension costs associated with older, long service employees. As discussed above,<sup>96</sup> the negative effects that CB plan conversions tend to have on older employees are not necessarily inherent in the conversions. Employers can structure conversions in order to negate any costs that otherwise would be imposed on older employees.<sup>97</sup> To the extent that employers do not elect to implement conversions in ways that protect older employees, they have implicitly decided to decrease their pension expenditures for older employees.<sup>98</sup>

In sum, data indicate several factors leading to the conversion of TDB plans to CB plans. They include: (1) enhanced plan communication and increased employee appreciation of the pension plan; (2) a more attractive benefit package for the recruitment of new employees, particularly younger, more mobile workers; (3) the shift of plan benefits from older, longer-term employees to younger, shorter-term employees; (4) cost savings; and (5) funding flexibility. Not all of these factors are necessarily considered in every plan conversion. Employers also have the opportunity to minimize the negative effects of a plan conversion on older employees who are working at the time of the conversion.

### C. Plan Reversions of the 1980s

During the 1980s, a trend analogous to that of CB conversions

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92. BROWN, *supra* note 50, at 18-20.

93. *Id.* at 18-19.

94. *Id.* at 18. See *Survey of Cash Balance Conversions*, CASH BALANCE NOTES, May 2000, at 1, 3, available at [http://www.pwcglobal.com/Extweb/ncsurvres.nsf/docid/7C89EE478C4CD479853568FB00721096/\\$file/cashbal.pdf](http://www.pwcglobal.com/Extweb/ncsurvres.nsf/docid/7C89EE478C4CD479853568FB00721096/$file/cashbal.pdf) (last visited Mar. 29, 2004)(reporting 67% of respondents expected long term pension costs to be equal or greater to pre-conversion costs).

95. Zelinsky, *supra* note 30, at 707-08.

96. See *supra* notes 72-76 and accompanying text (discussing how a CB plan conversion may disadvantage older workers).

97. See Zelinsky, *supra* note 30, at 697-99 (discussing how employers can lessen the impact of a plan conversion for older employees).

98. *Id.*



occurred when employers terminated TDB plans holding tens of billions of dollars in assets and replaced some of them with DC plans. By the early 1980s, numerous TDB pension plans accumulated assets in excess of the projected future benefit obligations.<sup>99</sup> In fact, one economist at the Stanford Business School estimated that by 1980, pension plan overfunding reached almost \$50 billion and continued to increase over the next five years.<sup>100</sup> Whether the overfunding was attributable to aggressive funding of plans, a rising stock market, higher than expected interest rates, or conservative actuarial assumptions,<sup>101</sup> many plan trust funds appeared generously funded even when calculated on an ongoing basis.<sup>102</sup>

An employer could, while acting within the bounds of the law, recapture those excess plan assets by terminating its pension plan. Typically, the employer next established a DC plan as its continuing plan. In such a termination, the TDB plan was required to purchase annuities to pay participants their accrued benefits.<sup>103</sup> The employer could then recoup the excess assets remaining in the plan trust. With billions of dollars in excess plan assets, many employers chose to do exactly that during the 1980s. Between 1980 and 1987, looking only at reversions of \$1 million or more,<sup>104</sup> employers recovered more than \$18 billion, or more than forty-five percent of the total assets of the 1,635 affected plans.<sup>105</sup> On average, each employer receiving one of these reversions recouped more than \$11 million while the plan participants, the

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99. Mark Daniels, *Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies*, 9 HOFSTRA LAB. L.J. 25, 37-38 (1991); Kris Wehrmeister, Note, *Early Retirement Benefits and Gillis v. Hoechst Celanese Corp.: Same Desk, Same Job, So What?*, 28 U.C. DAVIS L. REV. 475, 510 n.317 (1995).

100. *Overfunded Pension Plans: Joint Hearing Before the House Select Comm. on Aging and the House Subcomm. on Labor-Mgmt. Relations of the Comm. on Educ. and Labor*, 99th Cong. 257 (1985) [hereinafter *Overfunded Pension Hearings*] (statement of Jeremy Bulow, Stanford Business School).

101. *PBGC Warns House Oversight Panel to Move Cautiously on Asset Reversion*, 191 DAILY LAB. REP. (BNA) A-10 (Oct. 3, 1988).

102. Another way to calculate liabilities is on the basis of a plan's obligations if it were to be immediately terminated. Using that approach frequently reduces expected liabilities and increases the amount of excess plan assets. See Norman P. Stein, *Reversions from Pension Plans: History, Policies, and Prospects*, 44 TAX L. REV. 259, 273-76 (1989) (discussing the difference between a plan's funding obligations at termination and on a continuing basis).

103. In the termination of a fully funded plan, all accrued benefits must be vested. I.R.C. § 411(d)(3) (2000).

104. The PGBG only keeps statistics on pension plans reversions of at least \$1 million. Stein, *supra* note 102, at 259 n.2.

105. Dana M. Muir, *Changing the Rules of the Game: Pension Plan Terminations and Early Retirement Benefits*, 87 MICH. L. REV. 1034, 1036 (1989).

nominal "plan beneficiaries," each received an average, total distribution of slightly more than \$12,000.<sup>106</sup>

This termination and recoupment of assets was unprecedented. In comparison, during 1979 employers terminated ten overfunded plans, which held total assets of \$18 million.<sup>107</sup> Additionally, the focus on large reversions significantly understated the scope of the plans affected because reversions occurred in both small and large plans. The PBGC's own estimates indicate that excess assets existed in a minimum of 4,800 of the 6,800 plans terminated during 1986.<sup>108</sup>

Two particular reversions provide a sense of the diversity of effects experienced by plan participants. The first occurred when the purchasers of the Great Atlantic and Pacific Tea Company (A&P) terminated its pension plan, recovering an excess greater than what they paid for the entire company.<sup>109</sup> A&P experienced severe financial difficulties during that time. Therefore, some argued that dipping into the pension funds was necessary to the survival of A&P and possibly preserving jobs.<sup>110</sup> In such a case, rational workers might be willing to trade future accruals of pension benefits and the associated retirement security for the continuation of their employment.

However, the picture in many reversions was quite different. When Texaco Inc. bought Getty Oil Co. in 1984, it terminated Getty's pension plan.<sup>111</sup> Texaco recovered about \$250 million in excess assets, which represented a small portion of the \$10.3 billion purchase price, to retire some of the debt incurred in the acquisition.<sup>112</sup> The affected employees and retirees reacted vociferously<sup>113</sup> and their objections highlight the concerns raised by plan terminations. Those becoming active employees of Texaco

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106. *Id.*

107. *Overfunded Pension Plans*, *supra* note 100, at 127, 129 (Briefing Materials on Plan Terminations and Asset Reversions to Employers prepared by the House Select Comm. on Aging).

108. *Amicus Curiae Brief for the Pension Benefit Guar. Corp.* at 3, *Mead Corp. v. Tilley*, 490 U.S. 714 (1989) (No. 87-1868).

109. KAREN FERGUSON & KATE BLACKWELL, *PENSIONS IN CRISIS* 122 (1995).

110. *Id.*

111. *PBGC Warns House Oversight Panel to Move Cautiously on Asset Reversion*, *supra* note 101, at A-10.

112. *Overfunded Pension Plans*, *supra* note 100, at 33 (statement of Arthur Wilson, President, Local 898, The Oil, Chemical & Atomic Workers Int'l Union); *Id.* at 298 (Letter of Leroy V. Scott, Chairman, Delaware Getty Retirement Group).

113. Of course this was not the only issue litigated as a result of Texaco's purchase of Getty. For discussions of Texaco's battle with Pennzoil over alleged inducement of breach of contract, see THOMAS PETZINGER, *OIL & HONOR: THE TEXACO-PENNZOIL WARS* (1987) and BRUCE WASSERSTEIN, *BIG DEAL* 189-92 (1998).

also became participants in Texaco's pension plan.<sup>114</sup> Their complaint echoes the complaints of today's older workers whose TDB plans convert to CB plans. Workers ultimately received lower benefits than they expected under the Getty plan.<sup>115</sup>

The cohort of retirees had other complaints.<sup>116</sup> After its termination, the Getty plan would no longer be available to pay the benefits promised to current retirees. Therefore, Texaco provided for those payments by purchasing annuities in accordance with ERISA.<sup>117</sup> However, because the amount of each annuity was established at the time of purchase, no provision was made for cost of living increases.<sup>118</sup> Retirees thus lost expected increases in their benefits, expectations based upon Getty's history of voluntarily and periodically increasing pensions to counter inflationary effects.<sup>119</sup> Retiree groups also expressed concern because the PBGC, which insures DB plans, did not insure against the default of annuities purchased when a plan terminated.<sup>120</sup> A union official argued that an annuity provider would have less of a sense of moral obligation to the plan participants than would the plan sponsor.<sup>121</sup> This did not become a problem for the Getty retirees, but the insolvency of Executive Life in late 1991<sup>122</sup> proved that annuities do pose a risk. Executive Life's default left numerous former participants, whose terminated plans had purchased annuities from Executive Life, with less than their full promised annuities and without PBGC protection.<sup>123</sup>

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114. *PBGC Warns House Oversight Panel to Move Cautiously on Asset Reversion*, *supra* note 101, at A-10.

115. *Id.*

116. Finally, both retirees and active employees objected to the relatively low interest rates used by Texaco to calculate the interest due on the return of participant contributions. *Overfunded Pension Plans*, *supra* note 100, at 33 (statement of Arthur Wilson, President, The Oil, Chemical & Atomic Workers Int'l Union); *id.* at 298 (Letter of Leroy V. Scott, Chairman Delaware Getty Retirement Group).

117. *Id.* at 299 (Letter of Leroy V. Scott, Chairman Delaware Getty Retirement Group).

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 34 (statement of Arthur Wilson, President, The Oil, Chemical & Atomic Workers Int'l Union).

122. *In re Unisys Sav. Plan Litig.*, 173 F.3d 145, 150 (3d Cir. 1999).

123. *See, e.g., Waller v. Blue Cross*, 32 F.3d 1337, 1339 (9th Cir. 1994) (addressing claims against plan fiduciaries who selected Executive Life as annuity provider upon termination of plan); *Pilkington PLC v. Perelman*, 72 F.3d 1396, 1397 (9th Cir. 1994) (alleging fiduciary breach in connection with selection of Executive Life as annuity provider upon plan termination and referring to DOL's interest because the "Secretary is [a] plaintiff in a number of other actions seeking to recover benefits for beneficiaries of plans damaged by Executive Life's collapse"); *Maher v. Strachan Shipping Co.*, No. 92-2834, 1996 WL 257566, at \*2 (E.D. La. May 14, 1996) (regarding claim against plan

As is true of the current trend of TDB to CB plan conversions, the TDB plan terminations of the 1980s captured an unusual amount of attention as pension plan changes go. The enormous dollar amounts involved in many of the reversions, their possible role in the accelerating merger and acquisition frenzy, and the potential effect on retirement security spawned critical journal articles,<sup>124</sup> attention in the popular press,<sup>125</sup> and congressional hearings.<sup>126</sup>

In another parallel with conversions, plan terminations and reversions generated substantial litigation as employees fought for a greater share of the assets from terminating plans. But, whether basing claims on theories of reasonable expectations,<sup>127</sup> ERISA's requirement that fiduciaries act for the exclusive benefit

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sponsor alleging fiduciary breach based upon insolvency of insurance company that issued annuity contracts). See also *In re Unisys Sav.*, 173 F.3d at 150 (considering issues associated with Executive Life's default on Guaranteed Insurance Contracts); *Texas Life, Accident, Health & Hosp. Serv. Ins. Guar. Ass'n v. Gaylord Entm't Co.*, 105 F.3d 210, 213-14 (5th Cir. 1997); *Honeywell, Inc. v. Minn. Life & Health Ins. Guar. Ass'n.*, 110 F.3d 547, 549-50 (8th Cir. 1997); *Bussian v. RJR Nabisco, Inc.*, 21 F. Supp. 2d 680, 685-86 (S.D. Tex. 1998).

124. See Dennis R. Coleman, *From Amato to Blessitt: Out of the Frying Pan, Into the Fire*, 15 TAX MGMT. COMPENSATION PLAN. J. (BNA) 343 (1987); Donald S. Grubbs, Jr., *Termination of Pension Plans With Asset Reversion: A Solution*, 10 J. PENS. PLAN. & COMPLIANCE 199 (1984); Richard A. Ippolito, *Issues Surrounding Pension Terminations for Reversions*, 5 AM. J. TAX POLY. 81 (1986); Bruce J. McNeil & John P. Griffin, *Rules on Reversions Reexamined*, 13 J. PENS. PLAN. & COMPLIANCE 291 (1987); Muir, *supra* note 105, at 1134; Martin A. Pepper & Jeffrey A. Perlmutter, *Accessibility of Surplus Pension Assets*, 9 J. OF PENS. PLAN. & COMPLIANCE 229 (1983); John H. Abbott, Comment, *Legislating Reversions: A Mistaken Path Leading to Drastic Results*, 26 SAN DIEGO L. REV. 1109 (1989); Carl A. Butler, Note, *Pension Plan Terminations and Asset Reversions: Accommodating the Interests of Employers and Employees*, 19 U. MICH. J.L. REF. 257 (1985); Charles F. Royster, *How Does the Blessitt Decision Affect Plan Sponsors?*, PENSION WORLD, Nov. 1987, at 52.

125. See David E. Barry & Richard W. Brady, *Business Forum: The Pension Problem: Let Pension Funds Help Companies, Too*, N.Y. TIMES, Oct. 30, 1988, at A2; Elizabeth Ehrlich, *AMF's Agony Over Tapping the Pension Till*, BUS. WK., Jan. 21, 1985, at 97; Karen Friedman, *Business Forum: Fulfilling the Pension Promise; Without Reversion, Business Won't Play*, N.Y. TIMES, Sept. 28, 1986, at C2.

126. See *Corporate Raiding of Worker Pension Plans: Hearings Before the Employment & Housing Subcomm. of the House Comm. of Gov't Operations*, 100th Cong. (2d Sess. 1988); *Overfunded Pension Plans*, *supra* note 100; *Pension Asset Raids: Hearings Before the House Select Comm. on Aging*, 98th Cong. (1st Sess. 1983).

127. *Van Orman v. Am. Ins. Co.*, 680 F.2d 301, 307-08 (3d Cir. 1982). See Jennifer L. Pratt, Note, *Reversion of Surplus Pension Assets Upon Plan Termination: Is It Consistent With the Purpose of ERISA?*, 62 IND. L.J. 805, 811-13 (1987) (discussing the reasonable expectancies argument in reference to *Van Orman*).

of plan participants,<sup>128</sup> traditional trust law concepts,<sup>129</sup> invalidity of a plan amendment granting the plan sponsor entitlement to the excess,<sup>130</sup> or truncated entitlement to early retirement benefits,<sup>131</sup> employees almost invariably lost their battles for some share of the excess assets.

Faced with widespread concerns about unfairness and impingement upon benefit expectations and in the face of the employees' failed legal challenges, Congress responded to concerns that plan assets should be preserved. In order to discourage employers from terminating plans, in 1986 they took their first step by imposing a ten percent tax on reversions.<sup>132</sup> In 1988, the tax increased to fifteen percent,<sup>133</sup> and then in 1990 it was raised to the current level of twenty percent.<sup>134</sup> The 1990 changes also, in effect, added an additional thirty percent tax, resulting in net tax of fifty percent if an employer terminated a plan without creating a qualified successor plan.<sup>135</sup>

Over the same period, an economic slowdown, problems in the junk bond markets and rising interest rates, converged to slow the market for mergers and acquisitions. This substantially slowed the pace of asset reversions for pension plans and increased tax revenues through the collection of the excise tax on those reversions that occurred. Reversion activity began to decline in 1988 and has stayed significantly below the level of the early- and mid-eighties.<sup>136</sup> However, the imposition of significant excise taxes is a controversial situation. By merging overfunded and underfunded plans, plan sponsors remain able to capture surplus assets.<sup>137</sup> More seriously, the effective unavailability of the surplus combined with contemporaneous limitations imposed on

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128. *Holliday v. Xerox Corp.*, 732 F.2d 548, 550 (6th Cir. 1984). See Pratt, *supra* note 127, at 815-18 (discussing the exclusive benefit argument).

129. See *Borst v. Chevron Corp.*, 36 F.3d 1308, 1315-16 (5th Cir. 1994).

130. See *Riley v. Murdock*, 825 F. Supp. 1215 (E.D.N.C. 1995) (finding no breach of fiduciary duty associated with plan amendment).

131. See *Mead Corp. v. Tilley*, 927 F.2d 756 (4th Cir. 1991). For extensive analysis of the early retirement issue, see Muir, *supra* note 105.

132. Tax Reform Act of 1986, § 86, Pub. L. 99-514, § 4972(a), 100 Stat. 2085, 2478 (1986).

133. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, §§ 12001, 12002(a), 102 Stat. 3342, 3702 (1988).

134. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990).

135. *Id.*

136. Jeffrey N. Gordon, *Employees, Pensions, and The New Economic Order*, 97 COLUM. L. REV. 1519, 1544 (1997); Lee G. Knight, et al., *An Application of the Analytic Hierarchy Process to Tax Policy Decisions: The Termination of Overfunded Pension Plans*, 12 AM. J. TAX POL'Y 101, 111 (1995). See Pension Benefit Guaranty Corporation, *1995 Annual Report* (1996). But see Jefferson, *supra* note 82, at 18 (arguing that business considerations, not the availability of reversions, are responsible for most voluntary plan terminations).

137. Gordon, *supra* note 136, at 1544.

plan funding tend to discourage employers from advance funding and may result in plans being unable to meet their benefit obligations.<sup>138</sup> Since employers retain the obligation to fully fund a DB plan should investment returns not meet expectations, some commentators argue that notions of plan "ownership," the balance of risk and reward and simple fairness, militate in favor of employers being able to realize any excess that results from unexpectedly favorable investment returns.<sup>139</sup> Otherwise, the effect is to discourage the sponsorship of DB plans so that an employer chooses between offering no plan at all or providing a DC plan, which raises other concerns.<sup>140</sup>

There are substantial parallels between the current conversions and the terminations of the 1980s. In both situations the changes primarily occur in overfunded TDB plans. In each case, the employees who tend to experience a loss of benefits are older, long service workers who feel that the employer is not keeping its side of the TDB plan bargain. As employees lost their legal challenges to the conversions, they turned to Congress. Like the 1980s, Congress will have to balance the employees' complaints of unfairness with the basic structure of the domestic pension plan system, allowing employers to choose the terms of the plans they offer or not to offer any plans at all. Before discussing these overarching systemic and policy issues it is first necessary to analyze the legal and ethical challenges raised against CB plan conversions, and examine the expected effects of enhanced disclosure requirements.

## II. LEGAL AND ETHICAL CHALLENGES TO CASH BALANCE PLANS

Opponents of CB plans allege that the plans violate a variety of substantive legal standards. Specifically, suits have been premised on breaches of federal and state age discrimination laws,<sup>141</sup> technical IRC and ERISA requirements governing pension plans,<sup>142</sup> and ERISA fiduciary issues.<sup>143</sup> Claims of an ethical nature have also been brought to bear against the plan conversions.<sup>144</sup> While these issues are not central to this article, a brief discussion is useful in order to understand the existing regulatory structure. After all, the vehemence, posturing, and arrogance of the discourse associated with these issues is more

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138. Jefferson, *supra* note 82, at 3-4; Knight, *supra* note 136, at 111-12.

139. Knight, *supra* note 136, at 111-12.

140. *Id.*

141. *See infra* Part II.A.1 (discussing the legal challenge of age discrimination).

142. *See infra* notes 174-210 and accompanying text (discussing the impact of the *Cooper* case).

143. *See infra* notes 211-219 and accompanying text (discussing CB plans).

144. *See infra* Part II.B (discussing ethical challenges to cash balance plans).

than a little unusual in the world of pension planning.

### A. Legal Challenges

#### 1. ADEA Issues

ADEA prohibits employers with twenty or more employees from discriminating in terms of employment against individuals who are age forty or older.<sup>145</sup> More specifically for present purposes, ADEA prohibits benefit plans from decreasing benefit accruals based on age.<sup>146</sup> A threshold question is whether the ADEA prohibition on reducing benefit accruals because of age<sup>147</sup> protects individuals who have not reached normal retirement age. While the ADEA does not contain any explicit provision limiting its retirement accrual protections to those who are at least normal retirement age,<sup>148</sup> one district court held that the import of the statutory language and legislative history provide the basis for such a limitation.<sup>149</sup> However, no other court to date has accepted this argument.

Critics of CB plans raise two more compelling ADEA arguments against the plans. First, they allege that the total annual plan contribution, defined as the sum of the pay component and investment return component, is smaller for older plan participants than for otherwise equally situated younger participants.<sup>150</sup> Thus, all CB plans inherently violate ADEA. For example, assume that a plan provides for a ten percent annual pay component and a four percent investment component. If two participants have equal salaries and have been at the employer the same number of years, but one employee is younger than the other, the investment component provision will cause that employee to accrue a higher benefit in any given year than the older employee. Because the younger employee has more years to work until she reaches normal retirement age than the older employee, her investment component of any given year's plan

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145. 20 U.S.C. § 623 (2000).

146. 29 U.S.C. § 623(i) (2000).

147. A similar question could be raised regarding the corresponding ERISA and IRC provisions. For a discussion of those provisions, see *infra* notes 174-210 and accompanying text.

148. *Eaton*, 117 F. Supp. 2d at 826-27.

149. *Id.* at 827-29. See Richard C. Shea et al., *Age Discrimination in Cash Balance Plans: Another View*, 19 VA. TAX REV. 763, 768 (2000) (stating “[i]ndeed, at one point the legislative history suggests that the rules are not intended to apply before normal retirement age at all”).

150. *Eaton*, 117 F. Supp. 2d at 817-18; *The Cash Balance Conundrum*, *supra* note 9, at 8 (statement of Joseph Perkins, former President of the American Association of Retired Persons); Gregory C. Braden et al., *Cash Balance Plan Litigation*, Aug. 6, 1999, at <http://www.abanet.org/tax/ppv-tx/lexis/547199908048.doc> (Apr. 4, 2004); Sheppard, *supra* note 76, at 171.

contribution is larger than the investment component of the older employee.<sup>151</sup> The older employee's argument, thus, is that this discrepancy in rates of benefit accrual causes the CB plan to violate ADEA's prohibition on age-based discrimination. Because this method of calculating accrued benefits is typical of the structure of CB plans, the import of the argument is that CB plans inherently violate ADEA.<sup>152</sup>

Employers respond that the difference in benefit accrual is dependent on the number of years between the date of the plan contribution and the date of normal retirement. The younger employees receive higher allocations of investment returns because younger employees have more years between the date of the contribution and the date of normal retirement than do older employees. The amount of the investment return component may be correlated with age, but age itself is not used in the calculation of the investment return.<sup>153</sup> Current ADEA case law tends to indicate that it is not an ADEA violation for employers to use criteria in employment where those criteria correlate with age.<sup>154</sup>

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151. This example assumes that the terms of the CB plan provide for accrual of the pay component and the investment component on it in the year that the pay component is allocated to the account. If the plan does not treat the entire investment component as an accrued benefit in that year, the plan will violate ERISA's prohibition on back-loading. *Eaton*, 117 F. Supp. 2d at 822-23 (refusing summary judgment on backloading question where plan varied interest rates and benefit formula).

152. *Engers v. AT&T Corp.*, No. 98-3660, 2000 U.S. Dist. LEXIS 10937, at \*26-27 (D.N.J. June 29, 2000) (refusing to dismiss a claim alleging that decreased accruals based on age violate ADEA and ERISA).

153. See *Forman & Nixon*, *supra* note 70, at 421-22 (discussing the interpretation of the language "benefit accrual" in provisions prohibiting age discrimination); *Zelinsky*, *supra* note 30, at 736-37 (citing permissible correlations between age and benefit reductions).

154. The circuit courts are divided on the import of the Supreme Court's opinion in *Hazen Paper Co. v. Biggins*, 507 U.S. 604, 609-11 (1993), for the viability of disparate impact claims under ADEA. Compare *Mullin v. Raytheon Co.*, 164 F.3d 696, 704 (1st Cir. 1999) (holding that "the ADEA does not impose liability under a theory of disparate impact"); *Salvato v. Ill. Dep't of Human Rights*, 155 F.3d 922, 926 (7th Cir. 1998) (holding that "in this circuit, at least, the ADEA does not permit liability based solely on disparate impact"); *Ellis v. United Airlines, Inc.*, 73 F.3d 999, 1009 (10th Cir. 1996) (holding that "plaintiffs cannot bring a disparate impact claim under the ADEA") with *Criley v. Delta Air Lines, Inc.*, 119 F.3d 102, 105 (2d Cir. 1997) (permitting a disparate impact claim only where the plaintiffs can show "a disparate impact on the entire protected group, i.e., workers aged 40 and over"); *Smith v. City of Des Moines*, 99 F.3d 1466, 1470 (8th Cir. 1996) (concluding that disparate impact claims can be brought under the ADEA); *Frank v. United Airlines, Inc.*, 216 F.3d 845, 856 (9th Cir. 2000) (permitting an age discrimination claim to be brought under ADEA based on a disparate impact theory). Other circuits have expressed doubt about whether a disparate impact claim may be brought under the ADEA but have not yet directly confronted the issue. See *DiBiase v. SmithKline Beecham Corp.*, 48 F.3d 719, 734 (3d Cir. 1995); *Rhodes v. Guiberson Oil Tools*, 75 F.3d 989, 1004



Employers, thus, have successfully argued that CB plans do not violate ADEA simply because plan accruals negatively correlate with age.<sup>155</sup>

CB proponents also stress that the decision to sponsor a CB plan typically can be defended as a reasonable business decision made without discriminatory intent. As discussed above, employers offer a variety of rationales in support of their conversion decisions.<sup>156</sup> To the extent that critics believe CB plans tend to unfairly front-load benefits, plan sponsors can point to the anti-backloading provisions imposed by ERISA and the IRC.<sup>157</sup> If plan sponsors adopt plan terms in order to comply with the anti-backloading rules it becomes difficult to argue that they selected the plan terms for the purpose of discriminating based upon age.<sup>158</sup>

Furthermore, those who advocate CB plans reason that the plans differ little from DC plans. Since no one alleges that DC plans inherently violate ADEA, the technical classification of CB plans as DB plans should not affect their legality under ADEA. After all, the typical DC plan also is made up of a pay component and an investment component. Consider the expectations of two employees who are similarly situated in all respects but for age. Assume the employer makes equivalent pay contributions to the accounts of both employees on January 15, 2000. If we then project out the value of those pay contributions to normal retirement age, including the investment component, the younger employee will expect to have a higher account balance than the older employee because the younger employee will have more years of investment earnings on the pay contribution. This is legal in a DC plan, and is effectively the same thing that occurs under the typical CB plan. The potential legal difference is that, in order to comply with technical DB plan statutory requirements, CB plan accrued benefits are typically defined to include both the pay component and the entire projected investment component on that pay component. Because ADEA prohibits plans from decreasing accrued benefits based upon the age of participants, CB plans may

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(5th Cir. 1996) (en banc) (DeMoss, J., concurring in part and dissenting in part); *Gantt v. Wilson Sporting Goods Co.*, 143 F.3d 1042, 1048 (6th Cir. 1998); *Turlington v. Atlanta Gas Light Co.*, 135 F.3d 1428, 1436-37 n.17 (11th Cir. 1998).

155. *Eaton*, 117 F. Supp. 2d at 826. See *Engers*, 2000 U.S. Dist. LEXIS 10937, at \*17-18 (dismissing a claim based solely on an alleged adverse impact on older employees).

156. See *supra* Part I.B.1 (discussing factors that entice employers to convert to cash balance plans).

157. See *infra* note 184 and accompanying text.

158. ASSOCIATION OF PRIVATE PENSION & WELFARE PLANS, DETAILED COMMENTS REGARDING CASH BALANCE PLANS 13-14 (2000), available at <http://americanbenefitscouncil.org/documents/dcrbcp000120.pdf> (last visited Mar. 26, 2004).

violate the statute whereas DC plans do not.<sup>159</sup>

Second, CB plan plaintiffs could argue that even if the plans do not inherently violate the ADEA, the methodology used in many plan conversions violates ADEA.<sup>160</sup> The effect of many conversions is to establish wear away periods for some employees. As discussed above,<sup>161</sup> the result of the wearaways is that, for some number of years, the benefits of the affected employees do not increase. Since the affected employees tend to be the older employees and older employees are more adversely affected by wearaways than equally situated younger employees, those older employees might argue that the conversion methodology violates ADEA.<sup>162</sup>

Numerous employers avoid the wearaway question altogether by grandfathering employees in the old plan or otherwise protecting participants in the TDB plan from any negative effects of conversion to a CB plan.<sup>163</sup> When conversions do result in wearaways that have a disparate impact on older employees, the employer again may argue that ADEA does not establish a cause of action based on disparate impact.<sup>164</sup> As in the case of CB plan structure, supporters of CB plans explain that the time it takes to wearaway a vested benefit from the old TDB plan is based largely on length of service and pay history.<sup>165</sup> Under this view, any correlation with age is simply insufficient to state an ADEA violation.<sup>166</sup> Finally, to the extent that the CB plan provides positive options to participants that were not available under the old TDB plan, such as the availability of lump sum cash-outs,

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159. See Jonathan Barry Forman, *Professor Responds to Cash-Balance Pension Plan Article*, 1999 TAX NOTES TODAY 20-141 (Feb. 1, 1999) (discussing the practical similarities between a traditional DC plan and a CB plan).

160. In an individual claim, an employee, claiming that he was chosen for lay-off due to age discrimination, tried to use his employer's adoption of a CB plan as age-based animus. The court rejected the claim because the terms of the conversion guaranteed the employee the greater benefit under either the old TDB plan or the new CB plan. *Goldman v. First Nat'l Bank of Boston*, 985 F.2d 1113, 1120 (1st Cir. 1993). This was not a claim directly against the CB plan or the conversion, and, thus, is of less importance for purposes of this article.

161. See *supra* notes 68-70 and accompanying text (defining the concept of a wearaway period and discussing its impact on employees).

162. *The Cash Balance Conundrum*, *supra* note 9, at 8 (statement of Joseph Perkins, former President of the American Association of Retired Persons).

163. See *supra* notes 72-76 and accompanying text (discussing techniques used by some companies to minimize the impact on employees when converting to a CB plan).

164. See *supra* notes 154-155 and accompanying text (stating that a negative correlation between benefit accruals and age does not establish a violation of the ADEA).

165. *The Cash Balance Conundrum*, *supra* note 9, at 92 (statement of John F. Woyke, Actuary and Benefits Consultant, Principal, Towers Perrin).

166. *Id.*

arguably the negative effect of any wearaways is offset by the positive aspects of the new plan.<sup>167</sup>

Between September 1999 and May 2000, more than 650 age discrimination complaints based upon CB plans were filed with the Equal Employment Opportunity Commission (EEOC).<sup>168</sup> However, after researching CB plan conversions and possible violations of the ADEA, the EEOC decided against taking a position on the issues.<sup>169</sup> Reports indicate that the EEOC's Chairwoman attributed the delay to "the complexity of the issue."<sup>170</sup> It also appears that the EEOC is divided internally over the issue of age discrimination in CB plans.<sup>171</sup> Although the agency received permission to file an amicus brief supporting the plaintiffs in one plan conversion case, the commissioners allegedly deadlocked over the agency's position and it did not file a brief.<sup>172</sup> The EEOC's Compliance Manual contains a section on employee benefits. The guidance specifically states that the EEOC has not reached any conclusion about the legality of cash balance plans under ADEA.<sup>173</sup>

## 2. IRC and ERISA Technical Challenges

As with ADEA, both the IRC and ERISA prohibit pension plans from reducing accrued benefits based upon age.<sup>174</sup> CB plan opponents rely on these provisions to make essentially the same arguments discussed above under ADEA<sup>175</sup>—the plans discriminate based on age.<sup>176</sup> In *Cooper v. IBM Personal Pension*

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167. See *id.* (discussing common benefits made available to employees when companies convert to a CB plan).

168. Congel, *supra* note 64, at 1333; Vineeta Anand, *Slow Going: EEOC Delays Decision on Cash Balance Fairness*, PENS. & INV., May 29, 2000, at 1.

169. Congel, *supra* note 64, at 1333; Anand, *supra* note 168, at 1. According to the relevant section of the EEOC Compliance Manual, "[t]he Commission is currently studying the allegations in these charges, and, . . . has reached no conclusion as to the lawfulness of cash balance plans." THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION, EQUAL EMPLOYMENT OPPORTUNITY COMMISSION COMPLIANCE MANUAL ch. 3, § V(C) (Oct. 3, 2000), available at <http://www.eeoc.gov/policy/docs/benefits.html> (last visited Mar. 26, 2004).

170. Anand, *supra* note 168, at 1.

171. *Id.*

172. *Id.*

173. EEOC, *supra* note 169, at ch. 3 § V(C).

174. 29 U.S.C. § 1054(b)(1)(H) (2000); I.R.C. § 411(b)(1)(H)(i) (2000). Typically, ERISA will preempt any state law claims, such as breach of contract claims or claims brought under state anti-discrimination statutes. See *Engers*, 2000 U.S. Dist LEXIS 10937, at \*3 n.1 (dismissing contract claims and claims based upon New Jersey's anti-discrimination law as preempted by ERISA).

175. See *supra* Part II.A.1 (describing the legal challenges raised to support the view that CB plans violate the ADEA).

176. Braden, *supra* note 150. See *Engers*, 2000 U.S. Dist LEXIS 10937, at \*26-27 (refusing to dismiss a claim alleging that decreased accruals based upon age violate the ADEA and ERISA).

Plan,<sup>177</sup> IBM plan participants won a challenge brought under ERISA section 204(b)(1)(H)(i),<sup>178</sup> which prohibits plans from reducing “the rate of an employee’s benefit accrual . . . because of the attainment of any age.”<sup>179</sup> The day after the *Cooper* decision, the Seventh Circuit held in *Berger v. Xerox Corp. Retirement Income Guarantee Plan*<sup>180</sup> that Xerox’s CB plan violated ERISA because of the methodology used to calculate lump sum distributions.<sup>181</sup>

a. IBM and Accruals that Decrease Due to Employee’s Age

ERISA requires accrued benefits to be determined based upon the actuarial equivalent of the benefits at an employee’s normal retirement age.<sup>182</sup> To calculate the annual accrual for each individual, a CB plan must determine the amount of a normal retirement age annuity benefit that could be purchased with that year’s total annual plan contribution made by the employer on behalf of the individual. Because older individuals are closer to receiving annuity payments, it is more expensive to provide annuities for them than for younger employees.<sup>183</sup> Furthermore, the interest credits under the plan are part of accrued benefits and are part of the annuity valuation.<sup>184</sup> Therefore, for any two employees similarly situated in terms of all relevant criteria except for age, the same annual plan contribution will purchase a smaller annuity for the older employee than for the younger employee. Thus, the *Cooper* Court decided that the smaller hypothetical annuities for older employees that result from this artificial calculation necessarily mean that the CB plan violates the IRC and ERISA.<sup>185</sup>

IBM argued that the pay component does not decrease based on age, despite the fact that the annuity calculation does reveal that older employees tend to earn lower rates of total accrued benefits than equivalently situated younger employees.<sup>186</sup> The disconnect between the pay component and age indicates that age is simply correlated with the varying accrual rates; however correlation alone is not sufficient to constitute a statutory violation.<sup>187</sup> Instead, the effect simply flows from the time value of

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177. 274 F. Supp. 2d 1010 (S.D. Ill. 2003).

178. *Id.* at 1017.

179. 29 U.S.C. § 1054(b)(1)(H)(i).

180. 338 F.3d 755 (7th Cir. 2003).

181. *Berger*, 338 F.3d at 764.

182. 29 U.S.C. § 1002(23)(A) (2000); I.R.C. §§ 411(a)(7)(A)(i), 411(c)(3) (2000).

183. MCGILL & GRUBBS, *supra* note 35, at 531.

184. *Cooper*, 274 F. Supp. 2d at 1021.

185. *Id.* at 1021-22. See *Zelinsky*, *supra* note 30, at 733-43 (discussing prohibition in age-based accrual reductions).

186. *Cooper*, 274 F. Supp. 2d at 1022.

187. *The Cash Balance Conundrum*, *supra* note 9, at 92 (statement of John

money.<sup>188</sup> While the employees claim that the statutory language is on their side in this debate, the employers counter that regulation is on their side. A proposed Treasury regulation explicitly states that “[a] defined benefit plan is not considered to . . . reduce the rate of benefit accrual on behalf of a participant because of the attainment of any age . . . solely because of a positive correlation between increased age and a reduction or discontinuance in benefit accruals or account allocation under a plan.”<sup>189</sup>

Similarly, commentators observed that a former employee’s ongoing entitlement to the annual allocation of an investment component provides a type of inflation protection.<sup>190</sup> Instead of viewing those investment component allocations as effectively decreasing late in life accruals, the commentators view the allocations as positive factors to ensure that account balances are not frozen for those employees who leave the plan prior to normal retirement age.<sup>191</sup> Furthermore, rather than entitlement to an investment component being tied to the age of the plan participant, CB plans typically continue those allocations beyond the death of a participant.<sup>192</sup> Allocations end only when a beneficiary begins to receive plan benefits.<sup>193</sup> Thus, the commentators conclude that if a reduction in benefit levels does exist, it is not because of age.<sup>194</sup>

Finally, the court rejected IBM’s argument that the statutory language does not define “benefit accrual rate,” and it is unreasonable to believe that the rate must always be calculated based on a normal retirement age annuity.<sup>195</sup> If, instead, accruals

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F. Woyke, Actuary and Benefits Consultant, Principal, Towers Perrin).

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

189. 26 C.F.R. § 1.411(b)-2(a) (1988). Professor Zelinsky argues that the proposed regulation is in conflict with the statute, and, thus, the plaintiffs’ statutory-based arguments should prevail. Furthermore, he observes that the examples provided by the regulations are not directly on point to the usual accrual patterns employed by CB plans. Zelinsky, *supra* note 30, at 736-37. Professor Zelinsky determines that CB plans violate the prohibition on age-based reductions in accruals because the cost of annuities is determined purely on the basis of the age of the participant. *Id.* at 742-43. However, annuity costs are dependent on factors other than age, such as whether the annuity covers more than one life, or whether it provides for a minimum number of payments. MCGILL & GRUBBS, *supra* note 35, at 137-42. Thus, depending upon the terms of the chosen annuities, two individuals of the same age would face different annuity costs. Whether CB plans meet the statutory requirement on this basis is both unclear and beyond the scope of this article.

190. Shea, *supra* note 149, at 774-75.

191. *Id.* at 776-77.

192. *Id.* at 777.

193. *Id.*

194. *Id.*

195. *Cooper*, 274 F. Supp. 2d at 1016-17, 1022. See *Eaton*, 117 F. Supp. 2d at 818-20 (discussing calculating accrual rates); Shea, *supra* note 149, at 766-

were measured by the annual increase of the current CB in the participant's account, most CB plans would comply with this requirement.<sup>196</sup> Alternatively, compliance could be evaluated by looking to the language of the plan, or to the value of immediate annuities at current age.<sup>197</sup>

In December 2002, the Treasury Department and the IRS published proposed regulations that concluded that some standard CB plan paradigms are not age discriminatory for purposes of ERISA and the IRS.<sup>198</sup> The proposed regulations did substantially limit the approaches that may be used by an employer implementing a CB plan.<sup>199</sup> Due to the extensive comments submitted on the proposed regulations, the IRS has not yet issued final regulations.<sup>200</sup> In the meantime, the IRS continues to refuse to issue determination letters on new or converted CB plans.<sup>201</sup>

#### b. Xerox and Lump Sum Calculations

The *Xerox* case involved arguments predicated on another esoteric-sounding basis. The basic allegation in that case was that CB plans "whipsaw" participants by using different interest rates for different purposes<sup>202</sup> or by otherwise calculating lump sum benefits in ways that minimize those benefits. The calculation methodology used by the Xerox plan provides a good example of the controversy.

A participant who left employment prior to normal retirement age (NRA) had two choices: (1) wait and receive a benefit at NRA or (2) take an immediate lump sum from the plan.<sup>203</sup> A participant who waited until NRA to receive the benefit would properly receive all the interest credits provided for by the plan at the rate of the one-year Treasury rate plus one percent, including credits between date of separation and NRA.<sup>204</sup> In contrast, a participant who elected an immediate lump sum would receive interest credits after termination only at the same interest rate used to discount the result to a present value—an interest rate that by statute is established by the PBGC.<sup>205</sup> The net result is that a participant's immediate lump sum entitlement would be less than if the interest crediting is done using the plan rate so long as the PBGC rate was

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72 (discussing why Professor Zelinsky's proposals misinterpret the law).

196. *Eaton*, 117 F. Supp. 2d at 820.

197. *Shea*, *supra* note 149, at 772-74.

198. 67 Fed. Reg. 76123-01, 76124 (Dec. 11, 2002).

199. *Id.* at 76123-24.

200. *The Cash Balance Plan Hearings: A Recap*, *supra* note 4, at 9.

201. *Id.*

202. Zelinsky, *supra* note 30, at 723-24, 748-53.

203. *Berger*, 338 F.3d at 758-59.

204. *Id.* at 759.

205. *Id.* at 760.

lower than the estimated plan rate.<sup>206</sup>

Not only did the district court determine that this violated ERISA, it awarded the plaintiff class \$300 million as the amount Xerox underpaid in lump sums.<sup>207</sup> The Seventh Circuit affirmed except with respect to some relatively minor adjustments to the calculation of damages.<sup>208</sup> The key to the Seventh Circuit court's rationale is its determination that, as the district court decided in *Cooper*,<sup>209</sup> accrued benefits in a CB plan include future interest credits calculated at the normal rate specified by the plan.<sup>210</sup>

c. Fiduciary Obligations.

CB plans also have been challenged for violating ERISA's fiduciary requirements.<sup>211</sup> ERISA requires benefit plan fiduciaries to act "solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries."<sup>212</sup> Employers that sponsor plans are plan fiduciaries to the extent that they exercise discretion over the operation of their plans.<sup>213</sup> Plaintiffs argue that when an employer converts its TDB plan to a CB plan in order to reduce its plan costs or to realize some other benefit for itself and its shareholders that the employer violates its fiduciary obligation by not making its decision "with an eye single to the interests of the participants and beneficiaries."<sup>214</sup>

However, the Supreme Court has drawn a distinction between discretionary actions involving plan management and an employer's decision-making in establishing and amending plan terms.<sup>215</sup> In a trilogy of recent cases, the Court confirmed that

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206. *Id.* at 760-61.

207. *Id.* at 757.

208. *Id.* at 764.

209. See *supra* note 183 and accompanying text.

210. *Berger*, 338 F.3d at 762.

211. *Corcoran v. Bell Atlantic Corp.*, No. 97-510, 1997 U.S. Dist. LEXIS 14662, at \*28-31 (E.D. Pa. Sept. 23, 1997) (dismissing plaintiffs' fiduciary claim on the basis of the settlor doctrine), *aff'd*, 159 F.3d 1350 (3d Cir. 1998). The complexity of converting a TDB plan to a CB plan also may lead to documentation issues that give rise to claims alleging breach of fiduciary duty. See *Engers*, 2000 U.S. Dist LEXIS 10937, at \*18-21 (refusing to dismiss claims that fiduciaries failed to document plan terms in a timely manner).

212. 29 U.S.C. § 1104(a)(1) (2000). See Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1108 (1988) (noting that "ERISA's exclusive benefit rule . . . imports into pension fiduciary law one of the most fundamental and distinctive principles of trust law, the duty of loyalty").

213. 29 U.S.C. § 1002(21)(A). See generally Dana M. Muir, *Fiduciary Status as an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMPL. L. 391 (2000) (discussing ways in which employers rely on ERISA's fiduciary provisions as a shield against liability).

214. *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).

215. *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 443 (1999); *Lockheed*

employers do not act as fiduciaries when they adopt, amend or terminate their employee benefit plans.<sup>216</sup> This “settlor doctrine,” is founded on the rationale that, when adopting, amending or terminating plans, an employer plays a role analogous to that of the settlor of a testamentary trust.<sup>217</sup> In the CB plan context, the settlor doctrine means that an employer does not breach its ERISA fiduciary obligations by establishing CB terms that are favorable to itself.<sup>218</sup>

### B. Ethical Challenges

In addition to the legal challenges, critics of CB plans allege that plan conversions impinge upon employees’ reasonably established expectations and, thus, unfairly negate the implicit contract made between the employees and the employer just as the time has come for the employer to pay its share of that bargain.<sup>219</sup> Conversions from TDB to CB plans often negatively affect older, long-term workers either by establishing wearaways that provide lower benefit accruals in the final years of employment or by eliminating early retirement benefits.<sup>220</sup> In cases, employees’ complaints ring with notions of unfairness and dashed expectations. One twenty-eight year employee testified to Congress that he lost “approximately 30% of the value of [his] pension, which translate[d] into a lump-sum dollar loss well in excess of \$400,000”<sup>221</sup> in a plan conversion. In the words of other employees: “I am a 25 year Bell Atlantic employee who has had his pension cut about 30%,”<sup>222</sup> “[m]y best estimate is that the change will cost me about \$7500/year when I retire,”<sup>223</sup> and “[t]he end result is that I have lost 41-42% of my age—65 annual pension benefit.”<sup>224</sup>

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Corp. v. Spink, 517 U.S. 882, 890-91 (1996); Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995). For an extensive discussion of these cases, see Dana M. Muir, *The Plan Amendment Trilogy: Settling the Scope of the Settlor Doctrine*, 15 THE LAB. LAW. 205 (1999).

216. *Hughes*, 525 U.S. at 443; *Spink*, 517 U.S. at 890-91; *Curtiss-Wright*, 514 U.S. at 78.

217. *Hughes*, 525 U.S. at 443.

218. *Corcoran*, 1997 U.S. Dist. LEXIS 14662, at \*28-31.

219. *The Cash Balance Conundrum*, *supra* note 9, at 30 (statement of Karen Ferguson, Director of The Pension Rights Center).

220. See *supra* notes 68-71 and accompanying text (discussing plan changes that decrease benefits for older workers).

221. *The Cash Balance Conundrum*, *supra* note 9, at 3 (statement of James A. Bruggeman, Employee of Central and South West Corporation).

222. *Archived GuestBook* (June-Oct. 17, 1999), at [http://www.cashpensions.com/](http://www.cashpensions.com/welcome.html#guestbk)

welcome.html#guestbk (last visited Feb. 25, 2004) [hereinafter *Archived GuestBook*] (comment of Gregg Heinold on Oct. 15, 1999).

223. *Id.* (comment of Larry Franks on Oct. 8, 1999).

224. *Id.* (comment of John Staudt on Sept. 28, 1999).



Employees argue that under the deferred wage theory of pension plans, they work in exchange for their total compensation package—cash compensation, health care benefits, future pension benefits, and so forth.<sup>225</sup> That theoretical view of pension earnings in a TDB plan suggests that employees work for low levels of pension accruals during their early years of employment in exchange for higher rates of accruals in their final years.<sup>226</sup> In effect, they are under compensated in the early years of the employment relationship and over compensated in the later years. Applying that theoretical perspective on pension plans, the employees' comments quoted above reflect their view that the employer breached the parties' implicit deferred wage contract. The employers reaped the benefit of low rates of compensation in the early years and now refuse to pay the higher rates expected by the employees in the final years of employment.

However, the debate is not occurring solely on a theoretical level, and employee complaints also reflect employees' bitterness and sense of unfair treatment. A few consultants and actuaries have fed employee frustration by making widely publicized comments that acknowledge some of the more problematic results that can be associated with CB plans. For example, an attorney testifying at a Senate Pension Hearing testified that one actuary informed his colleagues "it is easy to install a CB plan in place of a TDB plan and cover up cutbacks in future benefit accruals."<sup>227</sup> Another expert explained that "what I have found is that while the employees understand [CB plan benefits], it is not until they are actually ready to retire that they understand how little they are actually getting."<sup>228</sup>

Employers respond to charges of unfairness and breach of the implicit employment bargain by pointing to their legal right to modify the benefit plans they sponsor.<sup>229</sup> Invariably, the employer has reserved its right to amend or terminate its TDB plan.<sup>230</sup> Absent unusual circumstances, such disclaimers effectively negate any allegations that parties had entered into an enforceable contract preventing the modification of plan terms during the term

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225. See Lorraine A. Schmall, *Keeping Employer Promises When Relational Incentives No Longer Pertain: "Right Sizing" and Employee Benefits*, 68 GEO. WASH. L. REV. 276, 286 (2000) (noting that pensions are an integral part of American compensational systems).

226. *Id.* at 287-88.

227. *Hearing on Pension Issues Before the Senate Comm. On Finance*, 106th Cong. (1999) (statement of Robert F. Hill, Esq., trial attorney, Denver, Co.).

228. *Id.*

229. *Curtiss-Wright*, 514 U.S. at 76-77 (exemplifying an employer's legal right to modify).

230. *Id.* at 76 (referring to the Curtiss-Wright plan's amendment language as the "standard reservation clause"); CANAN, *supra* note 32, at §§ 13.1-13.3.

of employment.<sup>231</sup> Similarly, the settlor doctrine, which is now well established by the Supreme Court, protects employers from breach of fiduciary duty claims.<sup>232</sup> In effect, employers rely on their legal rights to challenge the legitimacy of the employees' pension expectations.

The employers' legal right to amend their benefit plans also supports the argument that the deferred wage theory only legitimizes those employee expectations that incorporate "both the reality of existing pension coverage and the risk that such coverage might change in the future."<sup>233</sup> Furthermore, an employer can end its obligations associated with its DB plan by replacing the DB plan with a DC plan or not providing a pension plan at all. For the participants, a CB plan is likely to be preferable to either of these alternatives.<sup>234</sup>

A second, related argument on the fairness of CB plan conversions is that a conversion permits a plan sponsor to achieve much the same effect as if the sponsor terminated the TDB plan and replaced it with a DC plan. However, unlike the TDB to DC sequence, a TDB to CB conversion technically is not a plan termination. The conversion need not meet any of the extensive rules for plan termination<sup>235</sup> and does not give rise to any of the tax liabilities.<sup>236</sup>

As seen above, the terminations of the 1980's engendered so much controversy that Congress discouraged terminations by imposing hefty tax penalties for terminations of overfunded TDB plans.<sup>237</sup> Those taxes have been effective in achieving that goal.<sup>238</sup> Subsequently, employers adopted the technique of using a CB plan conversion instead of a plan termination. For example, by converting its plan, an employer can transform its plan into one that changes the pattern of benefit accruals from that of a TDB plan to a smooth pattern that mirrors those provided by a DC plan. The employer also can report lump-sum benefits to

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231. *Sprague v. Gen. Motors Corp.*, 133 F.3d 388, 399-400 (6th Cir. 1998).

232. See *supra* notes 215-218 and accompanying text (discussing the settlor doctrine).

233. Zelinsky, *supra* note 30, at 756.

234. A terminating DB plan will be assessed substantial tax obligations, thereby reducing the amount of plan assets available for participant benefits. See *supra* notes 132-135 and accompanying text (discussing Congressional taxation of DB plan terminations). Many believe CB plans to be superior to DC plans because in CB plans, the investment risk tends to reside on the employer, participants enjoy PBGC insurance protection, and so forth. See *supra* notes and accompanying text 50-55 (discussing the attractiveness of CB plans).

235. *Hughes*, 525 U.S. at 446-47.

236. I.R.C. § 4980 (2000).

237. See *supra* Part I.C (discussing plan reversions during the 1980s).

238. See *supra* notes and accompanying text 132-136 (discussing Congressional taxation).

employees and provide for lump-sum benefit payouts both of which are more usual in DC plans than in TDB plans. Thus, critics allege that the plan conversions are a technical way of avoiding the penalties against the termination of overfunded TDB plans, while still achieving similar results.<sup>239</sup>

Again, the response by those who support CB conversions tends to rely on the legality of the conversions. In a non-CB plan context, the Supreme Court rejected an argument that extensive amendments made by Hughes Aircraft to its pension plan were the functional equivalent of a plan termination and should be regulated as such.<sup>240</sup> Given the Supreme Court's continuing emphasis on formalism in ERISA analysis, employers have substantial authority for their position that the courts should not treat conversions of TDB plans to CB plans as the functional equivalent of TDB plan terminations.<sup>241</sup> Nonetheless, while this argument responds to the objections at a legal level, it sidesteps the underlying allegations of unfairness and improper use of a complex maneuver to avoid substantial excess taxes.

### III. RATIONALES FOR INCREASED DISCLOSURE

Approaches to the increased regulation of conversions from TDB plans to CB plans may be grouped into two categories. First, substantive regulation could be imposed on the conversions. For example, employees might be guaranteed the right to continue to accrue benefits under the same terms as provided by the original plan.<sup>242</sup> Or, plans might be prohibited from imposing wearaways.<sup>243</sup> The second possible approach to regulation is one that concentrates on increasing the disclosure associated with conversions as opposed to substantively regulating the terms of

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239. *Advisory Council Report*, *supra* note 10 (testimony of Professor Norman Stein).

240. *Hughes*, 525 U.S. at 446-47.

241. *Advisory Council Report*, *supra* note 10 (testimony of Professor Norman Stein).

242. Older Workers Pension Protection Act of 1999, H.R. 2759/S. 1600, 106th Cong. § 2 (1999); Pension Benefits Protection and Preservation Act of 1999, H.R. 2902/S. 1640, 106th Cong. § 3 (1999). See *The Cash Balance Conundrum*, *supra* note 9, at 8 (statement of Karen Ferguson, Director of The Pension Rights Center) (arguing substantive regulation on CB conversions should include three components: (1) employee option to be grandfathered in original plan, (2) protection of employees' reasonable expectations, and (3) taxation of conversions that fail to comply with item (1) or (2)); *id.* at 9 (statement of Joseph Perkins, former President of the America Association of Retired Persons) (proposing that (1) employees have choice of plans or be grandfathered in original plan, and (2) plans be prohibited from "freezing" benefit accruals for older employees).

243. See Pension Benefits Protection and Preservation Act of 1999, H.R. 2902/S. 1640, 106th Cong. § 3 (1999); Older Workers Pension Protection Act of 1999, H.R. 2759/S. 1600, 106th Cong. § 2 (1999).

plan conversions. Increased disclosure is the approach that was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),<sup>244</sup> thus, this Article focuses on it.

Prior to EGTRRA's passage, legislative proposals to mandate increased disclosure about plan conversions spanned a broad spectrum in their approach to the issue.<sup>245</sup> At one end of that spectrum, Representative Robert J. Portman's Comprehensive Retirement Security and Pension Reform Act would have required that participants receive notice of any applicable plan changes at least thirty days prior to their effective date.<sup>246</sup> Prior law required notice to be given at least fifteen days prior to the effective date.<sup>247</sup> Representative Portman's proposal, requiring notice to explain the reduction in plan benefits had no provision for providing any individualized participant information.<sup>248</sup> At the other end of the spectrum, bills proposed by Representative Gerald C. Weller and Senator Daniel P. Moynihan would have required any plan that is reducing future benefit accruals<sup>249</sup> to provide individual plan participants with specific comparisons of their benefits under the original plan and under the proposed plans.<sup>250</sup> Those comparisons would have been required to have been made on both a current and a projected basis.<sup>251</sup> In the middle was a proposal that would have required plans to provide participants with illustrative examples of the effect of proposed plan amendments.<sup>252</sup> In addition, any participant who requested it would have been entitled to sufficient information about the assumptions used in the examples to enable the participant to calculate the effect of the proposed amendment on his own benefit.<sup>253</sup>

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244. EGTRRA, Pub. L. No. 107-16, 115 Stat. 70 (2001).

245. The bills were similar in that all three of the major bills would have applied to any plan change that involved a "significant reduction in the rate of future benefit accrual." The Comprehensive Retirement Security and Pension Reform Act of 1999, H.R. 1102, 106th Cong. § 407 (1999). See Pension Right to Know Act, H.R. 1176/S. 659, 106th Cong. § 2 (1999) (applying to "large defined benefit plan[s]" that are amended with the "effect of significantly reducing the rate of future benefit accrual"); Pension Reduction Disclosure Act, H.R. 3047/S. 1708, 106th Cong. § 2 (1999) (applying to amendments "provid[ing] for a significant reduction in the rate of future benefit accrual").

246. The Comprehensive Retirement Security and Pension Reform Act of 1999, H.R. 1102, 106th Cong. § 407 (1999).

247. 29 U.S.C. § 1054 (2000).

248. The Comprehensive Retirement Security and Pension Reform Act of 1999, H.R. 1102, 106th Cong. § 407 (1999).

249. See *supra* notes 65-67 and accompanying text (discussing how CB plans tend to reduce plan accruals).

250. Pension Right to Know Act, H.R. 1176/S. 659, 106th Cong. § 2 (1999).

251. *Id.*

252. *Id.*

253. *Id.*

The compromise adopted in EGTRRA requires plans to give written notice to plan participants about any plan amendment that would significantly reduce the rate of future benefit accruals.<sup>254</sup> Thus, the provision is not limited to CB plan conversions. In fact, it would not even apply to conversions that do not result in a reduction of future benefit accruals. Substantively the legislation simply requires that the notice disclose sufficient information that the participants can understand the amendment's effect. The notice must be given "within a reasonable time" before the amendment becomes effective.<sup>255</sup>

Three possible rationales explain the adoption of increased disclosure requirements for TDB plans that convert to CB plans. In the discussion that follows, this Article describes these rationales based upon the effect the increased disclosure would be expected to have on decision-making. This article categorizes those possibilities as having: (1) a group effect; (2) an individual effect; or (3) a relational effect.

If all plans provided the information at issue in the absence of legislation, there would be no reason for legislative change. At least in some instances, then, enhanced disclosure requirements can be expected to result in more information being provided to individuals affected by the plan changes than those individuals would have had in lieu of the regulatory requirement. This is true whether the increased information simply provides earlier notice of plan changes, or whether it supplies participant-specific benefit comparisons under the original and amended plans.

Simply understanding that more extensive disclosure requirements will result in affected parties having more information does not alone describe the effect that disclosure will have on decision-making. Considering the potential effects more specifically, one possibility is that the increased information will enable employees to better understand how they will be affected by the plan amendment. As a result, employees may mobilize and take collective action to defeat or modify the plan conversion. In this scenario, the result of increased information is that the employees convince their employer to change its course of action vis-à-vis the pension plan. Similarly, the existence of the enhanced disclosure requirements might affect the decision of an employer contemplating a conversion to a CB plan. The employer knows it must provide advance disclosure about a plan change that would have an adverse effect on at least some employees, thus the employer may decide to avoid the negative employee response it would expect from the change. The result would then be that the employer would not convert its plan or would undertake a

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254. EGTRRA, Pub. L. No. 107-16, § 659, 115 Stat. 70 (2001).

255. 29 U.S.C. § 1054(h)(3) (2000).

conversion that is more favorable to the employees than it otherwise would have been. Whether the effect of increased information occurs because of explicit employee action or implicit pressure on employers, these outcomes are similar in that the imposition of disclosure requirements affects the rate or terms of plan conversions. In any given plan, all similarly situated plan participants are affected to an equal degree; therefore, this Article refers to this as the “group effect” of increased disclosure requirements.

Second, increased disclosure could have an “individual effect” on decision-making. Assume increased disclosure does not give rise to a group effect.<sup>256</sup> The result would be that, even though the plan must comply with enhanced disclosure requirements, the increased information would not have any effect on plan-level decision-making. The plan would be converted from a TDB to a CB plan under the same terms as would have occurred in the absence of the enhanced disclosure. However, the increased availability of information may enable some plan participants to understand that their employer-sponsored plan benefit will be less under the CB plan than it would have been under the TDB plan. On an individual basis, some plan participants may respond by acting differently outside of the plan than they otherwise would have. For example, an employee may decide to change jobs and accept a position with an employer that offers a more lucrative pension plan than the converted CB plan. Or, an employee might increase personal retirement savings outside the employer-sponsored pension plan to offset the loss of expected plan benefits. Or, an employee might take a second job that provides additional pension benefits. Finally, an employee might decide to work longer than he planned at the original employer in order to receive the same benefit he expected under the original plan.

Third, it is possible that, at least for some employees, increased information will not result in either a group effect or an individual effect. Again, begin with the assumption that enhanced disclosure does not give rise to a group effect. It also is reasonable to assume that while increased information might cause some individuals to change their behavior, others will not. Because of personal wealth, family factors, or even simple lethargy, even if a conversion to a CB plan reduces their benefit entitlement, some individuals are likely to remain at the employer, save as little or as much as before, and retire on the same date they expected to retire before the conversion.

In the case of those individuals, the only effect of increased disclosure might be termed a “relational effect.” That relational

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256. See *infra* Part IV (discussing why enhanced disclosure might not give rise to a group effect).

effect is difficult to predict because individual employees may react differently to the information about the plan conversion. The enhanced information might positively affect the employee's attitude toward the employer because the employee is grateful that the employer has been open and honest about the plan change.<sup>257</sup> Or, the enhanced information might negatively affect the employee's attitude toward the employer because he understands how much he loses under the plan change, even though the loss does not affect his observable decision-making.<sup>258</sup>

#### IV. A VOTING MODEL FOR ENHANCED DISCLOSURE

For purposes of this section, this Article assumes that the primary goal of enhanced disclosure requirements is to have a group effect on CB plan conversions.<sup>259</sup> Opponents of conversions tend to decry the use of conversions or, at a minimum, the use of wearaways. Similarly, as discussed above, the ethical arguments against CB plans are founded in the unfairness implicit in defeating the implicit contract between employer and employees.<sup>260</sup> Providing participants with additional information solely for the purpose of enabling them to take actions such as increasing their personal savings rates would not address this implicit contract concern.

In order to predict whether increased disclosure would be expected to achieve the group effect that seems to be its goal, this

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257. See *Communicating Cash Balance Plans*, WATSON WYATT INSIDER, Apr. 2000, at <http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=9314&Component=The+Insider> (last visited Mar. 26, 2004) (discussing the relational gains of a good communications package).

258. There also may be a public relational effect between legislators and their constituents. For a cynical viewpoint, by imposing higher levels of disclosure requirements, legislators may satisfy constituents who demand a response to CB plan conversions. From the perspective of those constituents, the legislators will have taken action. The legislators, thus, derive increased political support from that interest group. However, because the disclosure requirements are ineffective in bringing about change at either the group or individual level, the interest group has not, in fact, improved its position. At the same time, because employers are able to go forward with CB plan conversions, after incurring the costs of increased disclosure, legislators experience no loss of political support from the employer side. See Dana M. Muir, *From YUPPIES to GUPPIES, Unfunded Mandates and Benefit Plan Regulation*, 34 GA. L. REV. 195, 268 (1999) (discussing a similar theory in the context of other benefit legislation).

259. The extent to which people appear to perceive CB plan conversions as being unfair supports this assumption. After all, providing participants with additional information solely for the purpose of enabling them to take actions such as increasing their personal savings rates would not affect any negotiations on the implicit contract between employers and employees.

260. See *supra* Part II.B (discussing the ethical challenges to cash balance plans).

Article develops and then applies a voting model. First, it identifies the stakeholders that would be expected to have an interest and a voice in the determination and adoption of a CB plan conversion. For each stakeholder group, it analyzes the group's expected position vis-à-vis a CB plan conversion. Although the stakeholders typically will not have a formal vote on the conversion of a TDB plan to a DC plan,<sup>261</sup> it is not unreasonable to expect the stakeholders to seek some input into such a decision. In fact, if they are expected to be disinterested in that decision, that too is a type of input. Here, the voting model is used as a proxy for stakeholder input. The section ends by discussing the expected results given the predicted voting patterns of the stakeholders.

A. *Stakeholder Groups and Their Positions  
on Cash Balance Plan Conversions*

The most obvious effects of CB plan conversions inhere upon employees. However, different employee demographic groups will be affected by a conversion in varying ways. To further complicate matters, the model anticipates that other stakeholders, in addition to employees, would be affected by the conversion of a TDB plan to a CB plan. As a result, the model also considers the expected voting patterns of shareholders, suppliers, management, and community members.

Because the specific terms of any given plan conversion may significantly affect the experience of stakeholders, this model makes a number of assumptions in order to standardize the analysis.<sup>262</sup> First, it assumes that the TDB plan, which is being converted, and the CB plan, which is replacing it, have equivalent costs.<sup>263</sup> Second, it assumes that a cohort of older, long service employees, referred to as the "older employee cohort," would experience a significant reduction in their normal retirement age benefits due to the plan conversion.<sup>264</sup> Third, it assumes that a

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261. Of course, in some situations, some stakeholders do receive the right to formally vote on a plan conversion. One example is the IBM shareholder proposal, which entitled all equity holders to vote on the IBM plan conversion. 2000 IBM PROXY STATEMENT, *supra* note 5, at 22-23.

262. Although the assumptions have the effect of simplifying on actual experience, the model still provides a basis to begin the discussion on the expected effects of increasing disclosure requirements for plan conversions.

263. This permits the model to control for the "richness" of the plan. In addition, some number of plan conversions do appear to be approximately cost neutral. *See supra* notes 92-93 and accompanying text (discussing a study regarding a shift in plan designs).

264. To the extent that employers fully protect their current employees from any negative effects of a plan conversion, the objections to conversions appear to decrease significantly. *See Stein, supra* note 73, at 32 (discussing Kodak as an example of an employer that protected its employees against the negative effects of a CB plan).



cohort of younger employees and potential employees, referred to as the “younger employee cohort,” would realize larger retirement benefit accruals, at least in the first ten years of their employment than they would have under the traditional plan, and would experience little or no reduction in their normal age retirement benefit.<sup>265</sup> Finally, the voting model assumes that the disclosure regime would result in full and accurate information being available to all stakeholder groups.

### 1. Older Employee Cohort

Given the foregoing assumptions, the conversion of a TDB plan to a CB plan causes the older employee cohort to experience a reduction in normal retirement age benefits. This group, therefore, would be expected to vote against such a plan conversion. In the past, the opposition of the older employee cohort may have carried significant weight. After all, by definition, the employer converting its plan is one that voluntarily adopted a TDB plan at an earlier time. It is widely accepted that some of the reasons that led employers to adopt TDB plans was that those plans helped to decrease turnover and increase employee retention.<sup>266</sup> Long service employees were valued for their experience and loyalty to the company. This value also was reflected in the positive correlation that tends to exist between compensation and length of service.

However, current workforce dynamics may reduce the voting power of the older employee cohort. To the extent that employers need to make a choice in allocating overall compensation and benefit costs between older and younger workers, a variety of factors may tend to militate in favor of the younger employee cohort. To the extent, then, that the interests of the younger employee cohort diverge from the older employee cohort, employers now may give more priority to the votes of the younger group. Furthermore, employers may believe that older employees now are relatively locked into their jobs. Anecdotal evidence indicates that during both booming and lean economic periods, experienced, older workers find it difficult to change jobs.<sup>267</sup>

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265. See *supra* notes 65-66 and accompanying text (discussing the accrual pattern of younger workers under a CB plan). The positive effect of the CB plan is enhanced for workers who leave after vesting in their benefits but before spending a full career at an employer. See Brown, *supra* note 50, at 18-25 (developing an analytical model of employee support for plan conversions predicated on employee turnover rates). There also may be a group of employees whose benefit entitlement would be minimally affected by the plan conversion. This Article assumes those employees are neutral regarding the adoption of the plan.

266. Scott, *supra* note 78, at 920.

267. Joseph Pereira, *Out of Options: A Worker's Quest for a Job Lands on a Street Corner*, WALL ST. J., Mar. 5, 2003, at A1; Robert Tomsho, *Left Out:*

Commitment to community, an existing benefit earned under the employer's retirement plan, other benefit programs, skills that are in relatively small demand in the marketplace, or even lethargy may cause the older employee cohort to be less mobile than the younger employee cohort. A rational employer might, thus, discount the vote of the older employee cohort as being irrelevant or at least minimal in its likely effect on the employees' expected job tenure and performance.

## 2. Younger Employee Cohort

The conversion to a CB plan enables young workers to earn benefits more quickly than they otherwise would have. In addition, the standard ability to choose a lump sum distribution when an individual changes jobs means that CB plan benefits are more portable than TDB plan benefits. Under the terms of traditional plans, former employees typically had to wait until retirement age to receive any benefit from the plan. Given these incentives, the younger worker cohort would be expected to enthusiastically support the conversion of a TDB plan to a CB plan. Their expected support would be particularly strong if they expected to spend less than their entire career at the employer.

In the past, the younger employee cohort may have taken a broader perspective on the effect of plan changes on older employees. Two factors would have militated in favor of the younger employee cohort deferring, at least in part, to the interests of the older employee cohort. First, because the goal of the younger employee cohort may have been to spend an entire career with an employer, they would have looked at the very long-term effects of a plan conversion. According to the assumptions of the voting model, the conversion would not have significantly affected the benefits of members of the younger employee cohort who would stay at the employer for their entire career. Given the lack of any discernable long-term difference to themselves, and a substantially harmful effect on their fellow workers in the older employee cohort, the younger group might vote against the conversion. However, if it is true,<sup>268</sup> that the younger employee cohort no longer expects or seeks career employment, then those workers may tend to vote more in their short-term best interest—meaning they would vote in favor of the conversion.

Second, in the past reputation concerns may have affected voting patterns. At least in theory, the younger employee cohort may have considered the employer's negative treatment of older

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*Joblessness is Low, So It's All the Harder Being Without a Job*, WALL ST. J., July 25, 2000, at A1 (detailing the unemployment of Robert Mabry, age forty-nine).

268. See *supra* notes 77-78 and accompanying text (discussing why CB plans are more efficient than TDB plans).

employees, and been concerned whether they too would suffer some type of negative economic consequences once they aged and became less valuable to the employer. Even if the younger employee cohort expected to personally benefit under the converted pension plan, the notion that the employer is willing to impose negative consequences on the older employee cohort might have given pause to the younger group. However, increased job mobility and decreased long-term employment expectations also would serve to undercut the younger employee cohort's concern with the reputation effect of a CB plan conversion.

In sum, given demographic and job changes, it is logical that bargaining power in the workplace has shifted to some extent from older to younger workers. Furthermore, the younger employee cohort may no longer engage in decision-making based upon a model of lifetime employment, if it ever did. Assuming that the younger workers vote in their short-term interest, they will vote for the benefit plan that provides them with the highest accrual rates in the near short term and offers the most portable benefits. That means that they will vote in favor of conversion from a TDB plan to a CB plan.

### 3. *Shareholder*

The voting model expects that non-employee equity shareholders will vote according to the perceived efficiencies of a potential plan conversion. In evaluating the efficiencies from the viewpoint of shareholders, a number of factors must be considered. First, shareholders would be expected to support pension plan terms that most efficiently address the retirement savings needs of the employer's workforce needs. As noted above, as a general matter employers believe that the younger employee cohort understands CB benefits better, and values them more highly than equivalent benefits from a TDB plan.<sup>269</sup> Second, the fastest growing job categories between 1998 and 2008 are all predicted to be information technology positions. Workers for those positions will tend to be younger, and may have shorter expected job tenures than do older workers. For the same reasons just discussed under the younger worker cohort, those workers will prefer CB plans to TDB plans. Thus, workforce considerations would be expected to lead shareholders to vote in favor of conversions to CB plans.

The ways in which pension plans are funded also may lead shareholders to vote in favor of conversion to a CB plan. An employer's obligation to fund a CB plan is more predictable than the funding obligations of a TDB plan. Historically, sponsors of TDB plans accepted all the investment risk associated with funding a plan where liabilities were heavily dependent upon

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269. See *supra* Part I.B.1 (discussing motivations for plan conversions).

variables such as salary levels, turnover, and longevity. If the investment returns were less than projected, the employer was responsible for increasing its contribution to offset the under funding. In comparison, CB plans specify a promised investment rate of return. The employer's liability for investment returns that are lower than expected is limited to the promised rate of return.<sup>270</sup> The sponsor of a CB plan, in this way, has more control over the effect of investment risk on its funding obligation than does the sponsor of a TDB plan. Shareholders may prefer the predictability associated with CB plan funding obligations.

For a firm with a substantial number of older employees, the accrual obligations of a TDB also could be an important factor to shareholders. Most conversions to CB plans are conversions of overfunded TDB plans.<sup>271</sup> Employers with an overfunded plan and a significant number of older workers approaching retirement age face two types of financial concerns. First, the increased benefit accruals of the older employees could consume the plan surplus. The employer then would be required to resume contributions to the plan. The renewal of contribution obligations obviously would affect the financial obligations of the firm. Second, even if increased accruals do not consume the entire pension plan surplus, they will cause the surplus to be lower than it would have been in the absence of the increased accruals. Current accounting methods permit employers to report pension plan gains as operating income and, before the recent declines in the equity markets and interest rates, that ability significantly enhanced the returns of numerous public companies.<sup>272</sup> For example, in 1999 IBM's financial results included \$638 million in pension income.<sup>273</sup> If surpluses are decreased, those returns also will be reduced. Both the potential for renewed contribution obligations and for lower reportable plan gains are reasons for shareholders to vote in favor of the conversion of an overfunded plan to a CB plan.

Although the theoretical analysis indicates that shareholders would be expected to support plan conversion, some anecdotal evidence also exists on this question. Arguably, one would not expect to see significant numbers of companies converting plans if the shareholders perceived the conversions to be against their interests. Thus, the significant rate of conversions that occurred,

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270. The sponsor of a CB plan can further limit its risk by defining the rate of return in terms of a floating index or other method that reflects changing market conditions. See *supra* note 55 and accompanying text (discussing possible rates for the investment component). See also Forman & Nixon, *supra* note 70, at 408-09 (discussing an employer's ability to benefit by the spread between actual and promised rates of return in a CB plan).

271. See *supra* note 89 and accompanying text (discussing how CB plans are established).

272. See *supra* note 25 and accompanying text (discussing pension plans).

273. Anand, *Full Disclosure*, *supra* note 25, at 1.

particularly among large public companies,<sup>274</sup> provides support for the theoretical results.

As a more specific anecdotal example, though, we can ask whether the IBM situation calls the theoretical analysis into question. While the controversy over IBM's conversion to a CB was ongoing, IBM's proxy statement for 2000 included a shareholder resolution opposing implementation of the CB plan. The resolution was sponsored by 344 employees who owned IBM shares,<sup>275</sup> and garnered 28.2% of the shares voted at the annual meeting.<sup>276</sup> Data indicates that, on average, shareholder proposals dealing with social policy issues typically attract a very low level of shareholder support.<sup>277</sup> One might ask then why the proposal against adoption of a CB plan at IBM gained acceptance with a greater percentage of the voting shareholders than does the normal social policy proxy proposal. One explanation consistent with the theoretical analysis is that significant support probably came from members of the older employee cohort who held IBM stock. However, this does not explain the voting in its entirety. Some large institutional shareholders such as the California Public Employee Retirement System (CALPERS) supported the proposal.<sup>278</sup> Similarly, Institute for Shareholder Services, a private service company that provides advice to institutional investors on issues such as shareholder proposals, encouraged its clients to vote in favor of the proposal.<sup>279</sup> A CALPERS spokesperson explained its support for the shareholder proposal by stating: "Withdrawing promised benefits for any employee is not only morally reprehensible, it is plain bad business."<sup>280</sup>

The critical question then becomes whether the type and scope of support received by the 2000 IBM shareholder proposal indicates a weakness in the model of expected shareholder behavior. The answer is that the IBM situation highlights the complexity in the theoretical model, but, at the end of the day, it supports the theoretical analysis. CALPERS' position signaled its

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274. See *supra* note 11 and accompanying text (discussing numbers of CB conversions in recent years).

275. 2000 IBM PROXY STATEMENT, *supra* note 5, at 22. See *I.B.M. Holders Reject Pension-Option Plan*, N.Y. TIMES, Apr. 26, 2000, at C12 (noting that about 300 million shareholders voted in favor of the proposal while about 765 million rejected it).

276. *I.B.M. Holders Reject Pension-Option Plan*, *supra* note 275, at C12.

277. Cynthia J. Campbell et al., *Current Perspectives on Shareholder Proposals: Lessons from the 1997 Proxy Season*, 28 FIN. MGMT. 89, 92 T.2 (1999) (indicating that in 1997, ninety social policy proposals received a mean of only 6.6% of all votes cast).

278. Duncan Hughes, *IBM Taken to Task on Pensions*, SUNDAY BUSINESS, Apr. 23, 2000; *Cash Balance Pension Plans*, at <http://bernie.house.gov/ibm/stockholder.asp> (last visited Mar. 1, 2004).

279. Hughes, *supra* note 278; *Cash Balance Pension Plans*, *supra* note 278.

280. Hughes, *supra* note 278.

agreement with the ethical arguments against CB plans discussed above.<sup>281</sup> CALPERS also appeared to be concerned with the reputation effect of IBM's actions.<sup>282</sup> In any given firm, some shareholders may agree with the ethical arguments and vote their conscience. Most others probably will not. Shareholders that differ from CALPERS in their view of CB plan conversions may do so not because they find them morally reprehensible, but because they may be driven by fiduciary obligations to constituencies. Alternatively, they may believe that CB conversions are not bad business. Instead, they may take the position, in accordance with the theoretical model, that CB conversions are in the best financial interest of the company. Perhaps most compelling, a shareholder proposal objecting to the cash balance plan was also included on the 2001, 2002, and 2003 IBM proxy statements.<sup>283</sup> Each year the shareholder support for the proposal has dropped with the specific supporting percentages being 27% in 2001; 19% in 2002; and 14% in 2003.<sup>284</sup>

In the end, the outcomes do support the analysis of the voting model. Even at IBM, which arguably was the highest profile, most publicized, most heavily fought battle that we have seen so far against implementation of a CB plan, the shareholder resolution lost by an overwhelming majority. Thus, given a choice between continuing a TDB plan and conversion to a DC plan of equivalent costs, the model predicts that shareholders would vote in favor of the CB plan conversion.

#### 4. Suppliers

The interests of suppliers appear to align with the interest of shareholders and reflect some of the same complexities. As with shareholders, some suppliers who believe that a CB plan conversion is an unethical act may follow their conscience and oppose the conversion. Others may believe, for ethical or reputation reasons, that conversions are bad business. Again, such suppliers may vote against a conversion.

However, just as the majority of shareholders are expected to support the CB conversions, suppliers are also likely to support them. The financial interests of suppliers are tied to the financial position of the company in a way similar to the ties between shareholders and a corporation. At a minimum, suppliers would benefit from a financially secure company that could maintain stable supplier relationships.

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281. See *supra* Part II.B (examining the ethical arguments opposing conversions).

282. *Hughes, supra* note 278.

283. Anne Krishnan, *IBM Shareholders Reject Pension Choice Proposal for Third Time*, THE HERALD-SUN, Apr. 30, 2003, at B1.

284. *Id.*

If anything, the relationship between supplier and company may be tighter because it may be more one-dimensional. In many companies, the older employee cohort may hold some number of company equity shares. In such an instance of overlap between the older employee cohort and the shareholders, the potential loss of an individual benefit under the TDB plan may outweigh the financial gain to be realized on the shareholding through the effect of the plan conversion. Such an individual would be expected to oppose the CB plan conversion. One would not, however, expect any significant overlap between the supplier population and the older employee cohort.

### 5. Management

Predicting the voting pattern of management is particularly difficult because management's interests may align with the interests of some of the stakeholders discussed above. The different groups of stakeholders will tug on management in varying ways. Under traditional views of corporate governance, management's primary agency obligations were governed by contractarian principles.<sup>285</sup> While complex in theory, the result was fairly simply—management's decision-making was aligned with the interests of equity shareholders.<sup>286</sup> As discussed above, non-employee shareholders may take different views of a CB conversion, but the model predicts that the majority of those shareholders would typically support the conversion. To the extent management acts in accordance with its obligations under the contractarian theory of corporate governance, management would be expected to vote in favor of the conversion of a TDB plan to a CB plan.

It is appropriate to consider whether the expectations under the traditional contractarian theory continue to hold true, and, even if they do, whether practical considerations might affect the voting patterns of management. First, the widespread adoption of corporate constituency statutes has broadened the types of interests that managers may consider when confronted with complex issues inherent in CB plan conversions.<sup>287</sup> The constituency statutes acknowledge that the interests of employees

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285. Michael Bradley et al., *Challenges to Corporate Governance: The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROBS. 9, 33-41 (1999).

286. *Id.* at 37.

287. *Id.* at 28. See Timothy L. Fort, *Religion in the Workplace: Mediating Religion's Good, Bad and Ugly Naturally*, 12 NOTRE DAME J.L. ETHICS & PUB. POL'Y 121, 146 (1998) (stating that the "[s]takeholder theory has legal manifestations in the form of corporate constituency statutes in which over half the states generally allow, but do not require managers to take into account nonshareholder constituents when making managerial decisions").

are among the legitimate factors that may deserve consideration by management.<sup>288</sup> Recognizing that management may weigh the interests of employees brings forward a new complexity. As discussed above, the younger employee cohort will likely vote in favor of plan conversion whereas the older employee cohort will likely vote against conversion. Thus, permitting management to consider employee interests does not resolve the question of how management would vote.

From a practical standpoint, it is useful to recognize that management is, of course, comprised of employees. Members of management too would be participants in the TDB plan and may experience effects of a plan conversion. To the extent that members of management are more likely members of the older employee cohort rather than the younger employee cohort, their personal interests may align with the older cohort. If they approach the conversion decision from a position of self-interest, management could follow the same voting pattern as the older employee cohort. In such a case, management would vote against plan conversion.

The complexities embedded in management's theoretical obligations and the implications of potential self-interested behavior raise some significant concerns in predicting management's voting behavior. The basic concepts observed for other constituencies do permit some insights. The interests of shareholders, suppliers, and the younger employee cohort militate in favor of management support for plan conversions. The interests of the older employee cohort would likely align with the self-interest of management against the conversion of plans. Yet, as noted above, the changing demographics of the workplace diminish the influence of the older employee cohort. In many companies, separate benefit plans for top management provide higher levels of pension benefits than could be provided under either a TDB or a CB plan so, in truth, management probably would lose little through the CB plan conversion.<sup>289</sup> Shareholder monitoring should decrease the likelihood that management would act in its own self-interest.<sup>290</sup> Thus, significant factors limit the

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288. Bradley, *supra* note 285, at 28.

289. Plans that provide pension benefits in excess of what the IRS permits qualified pension plans to provide are known as excess benefit plans. For more information on those and other plans for top management employees, see Ridgeley A. Scott, *Rabbis and Other Top Hats: The Great Escape*, 43 CATH. U. L. REV. 1 (1993). According to IBM's 2000 Proxy Statement, "Retirement benefits are provided to the executive officers of the Company . . . under an unfunded, non-qualified defined benefit pension plan known as the Supplemental Executive Retention Plan (SERP)." 2000 IBM PROXY STATEMENT, *supra* note 5, at 16.

290. Melvin A. Eisenberg, *Symposium: Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1282-87 (1999).



likelihood management would vote against plan conversions. At the same time, other powerful forces should operate to encourage management to support conversions. The model, therefore, predicts that management will vote in favor of CB plan conversions. Practically speaking, anecdotal evidence supports the theory. Twenty percent of the country's Fortune 1000 companies would not have converted their pension plans from TDB plans to CB plans without the support of management.

## 6. *Community*

The voting patterns of the community stakeholders may be the least predictable of all. Community members might align with any of the stakeholder groups already discussed. Those alignments are unpredictable because they might depend upon social affiliations, economic relationships, ethical beliefs, future business plans, and so forth. For example, affinity groups of the older employee cohort might be concerned for their peers and fearful that their employer might make similar changes. Businesses that provide services to a customer base comprised primarily of members of the older employee cohort and their peers might join the opposition to plan conversion. Regardless of their affiliations, community members who are persuaded by the ethical arguments against conversions would be expected to vote against the conversions. These examples only begin to scratch the surface of the types of community members who might take an interest in plan conversions. That means, of course, that the analysis is equally nuanced regarding community members who would be expected to support plan conversions.

However, as with the analysis used for management, the predictions of the voting model for other stakeholder groups provide some insight for the expected community reaction. So far, the model predicts that the younger employee cohort, suppliers and shareholders will be the most influential voters. The majority are expected to vote in favor of plan conversions and to cause the majority of management to vote in favor as well. The opponents are the older employee cohort and, perhaps, limited numbers of shareholders and a few members of management.

The most significant question, then, becomes whether the conversion opponents could persuade enough community members to oppose CB plan conversions that together they could offset the stakeholders that support the conversions. Significant road blocks impede opponents from achieving such an outcome. The effect of the conversion of a TDB plan to a CB plan on the community will be limited. As a result, it is unclear the extent to which the community would be willing to become substantially involved. Most generally, employer-sponsored pension plan issues do not tend to generate the same level of community interest as do many

other employment-related issues, such as racial discrimination, sexual harassment, and affirmative action.

In addition, the members of the shareholder group that oppose the CB conversion may be too diverse for that group to effectively influence the community. To the extent that shareholders have an actual vote on a CB plan, as they did in the IBM situation, some of them may wield the vote against conversion. However, it is unclear whether they will actively and vocally oppose the plan conversion in ways that would motivate large numbers of community members to aggressively join the dissent.

That leaves the older employee cohort as the group that would carry the burden in exhorting community action. Historically, older segments of society have been successful in organizing interest groups to represent their social and economic interests. For example, they have long made retrenchment on social security programs politically unacceptable.<sup>291</sup> As repeatedly observed above, in the context of employment situations, workforce factors may limit the influence of the older employee cohort. Those factors, however, may not diminish the public voice of the older employee cohort. Thus, that group may be the most effective in seeking the attention and support of community members. Still it seems likely that in most situations, the older employee cohort will not be able to mobilize sufficient community aid to overcome the support of the younger employee cohort, shareholders, suppliers, and management.

### *B. Expected Results of the Voting Model*

Overall, the voting model predicts that stakeholders will support conversion of a TDB plan to a CB plan. The only constituent group that clearly would oppose the conversion is the older employee cohort. Currently, though, the position of that group vis-à-vis other employees and shareholders is not likely strong enough to affect the outcome of a conversion decision in the majority of cases. Additionally, while management's interests as senior employees might tempt them to align with the older employee cohort, significant constraints exist to minimize the likelihood of such an alignment. The interests of the community are the most difficult to predict, but it seems unlikely that the older employee cohort would mobilize sufficient support from the community to overwhelm the voting patterns of plan conversion proponents.

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291. Stewart E. Sterk, *The Continuity of Legislatures: Of Contracts and the Contracts Clause*, 88 COLUM. L. REV. 647, 720-22 (1988); Cass R. Sunstein, *Congress, Constitutional Moments, and the Cost-Benefit State*, 48 STAN. L. REV. 247, 291 (1996).

The voting model predicts that younger workers, shareholders, and suppliers all will favor conversion of a TDB plan to a CB plan. In addition, the model predicts that management will act in accordance with its agency obligations to shareholders and vote in favor of conversion. It is likely that those groups would also be successful in attracting some significant level of community support.

One of the assumptions underlying the voting model was that all stakeholders had full access to accurate information about the adoption of the CB plan, including its effect on the benefits of participants in the former TDB plan. Even with such information, the voting model predicts that companies would find adequate support for plan conversion. According to the model, even if the disclosure requirements associated with a plan conversion are increased, that increase would not slow the pace of CB plan conversion decisions. Nor would more information be expected to affect the terms of CB conversions. If anything, enhanced disclosure would ensure that each stakeholder group fully understands the effect of the conversion on the group. An increase in accurate information then would enable each group to more accurately determine the effect of the conversion on that group, and, thus, reinforce the predictions of the voting model.

#### V. COST BURDENS OF SUBSTANTIVE REGULATION

The primary insight of the voting model is that if the intent of regulators is to slow the pace of conversions or to affect their terms in order to decrease the harsh impact of conversions on the older employee cohort, then increasing the disclosure requirements is unlikely to be effective in achieving that goal. Instead, regulators would need to adopt substantive regulation to address those concerns directly. An analysis of the possible approaches to substantive regulation is beyond the scope of this article. The voting model does provide some insights, though, on the allocation of the cost burdens that would result from substantive regulation, and this section briefly outlines those insights.

Substantial evidence supports the common-sense notion that CB plans are viewed by employers as being more economically efficient than the TDB plans they replace. To review briefly, some employees may place a premium on CB plan benefits because they are easy to value, accrue more evenly over a career, and are more portable.<sup>292</sup> Converting to a CB plan also may financially benefit employers who otherwise would see significant increases in their funding obligations under a TDB plan, or a decrease in income attributable to the excess assets held by a TDB plan.<sup>293</sup>

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292. See *supra* Part I.B.1 (discussing motivations for plan conversions).

293. See *supra* notes 90-91 and accompanying text (commenting on the

The economic effect, then, of conversion of a TDB plan to a CB plan is to increase the competitiveness of the firm. If regulation prohibits conversions, or causes them to occur with less efficient terms, the effect is to cause the firm to be less competitive than it otherwise would be. The standard objection to regulatory interference with plan terms is the long-term implications for the DB plan system. By decreasing an employer's options once it has voluntarily decided to sponsor a TDB plan, the regulation discourages other employers from adopting DB plans.<sup>294</sup>

A short-term effect would incede primarily at the firm level. Precluding conversions or increasing their costs would cause the larger older U.S. firms that tend to adopt TDB plans to become less competitive than their newly established or foreign competitors who do not provide TDB plan benefits. Given the international boundaries and fierce competitiveness of the current economy, the TDB plan sponsor will not be able to pass the excess costs associated with plan sponsorship along to its customers or its suppliers. Perhaps the plan sponsor will be able to pass the costs along to the younger employee cohort in the form of lower than market wages or non-pension benefits but this will be difficult during periods of strong labor markets.

That leaves the plan sponsor two possibilities. First, it may be able to shift the excess TDB plan costs to the older employee cohort in the form of lower wages or non-DB plan benefits. The plan sponsor's ability to transfer the costs to the older employee cohort will depend on the labor market strength of that cohort. As discussed above, there is some evidence that the labor market leverage of that group may be weaker than the leverage of the younger employee cohort.<sup>295</sup>

If the plan sponsor cannot pass the excess TDB plan costs through to the older employee group, then the firm will be forced to absorb the costs. That, in turn, will mean that the firm will provide a lower rate of return to its shareholders. The equity value of the firm will decline, causing the shareholders to experience a decrease in their wealth.

The irony for regulation of CB conversions is that, regardless of whether the excess costs of the TDB plan are shifted directly to the older employee cohort or to shareholders, it is almost certain that the older employee cohort will bear a portion of the costs of the regulation. If the plan sponsor transfers the costs directly to the older employee cohort, the effect is clear. The effect is more

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increased costs associated with maintaining TDB plans).

294. Dana M. Muir, *Contemporary Social Policy Analysis and Employee Benefit Programs: Boomers, Benefits, and Bargains*, 54 WASH. & LEE L. REV. 1351, 1414-17 (1997).

295. See *supra* Part IV.A (discussing the older and younger employee cohort).

indirect if the plan sponsor passes the costs to shareholders. In the large, well-established companies that tend to sponsor TDB plans, the older employee cohort is likely to invest in employer securities. Thus, if costs are passed to shareholders, the older employee cohort will be affected in their role as shareholders.

This analysis leaves regulators with the following alternatives. First, the status quo could be maintained. While questions remain about the legality of conversions,<sup>296</sup> they continue to occur unabated and relatively few regulatory constraints are imposed upon the terms of the conversions. The older employee cohort bears the costs of conversion at least in the absence of any voluntary mitigating measures adopted by the plan sponsor during the conversion. Second, substantive regulation might be imposed to decrease the number of conversions or create more favorable terms for the older employee cohort. As just explained, the cost of that regulation would incide on the older employee cohort, either alone or together with other shareholders. Third, additional disclosure could be required. The voting model predicts that more information will not affect the rate or the terms of CB plan conversions. Again, in accordance with the model developed for substantive plan regulation, older employees alone, or in conjunction with shareholders would bear the costs of the increased disclosure.

Obviously, the analysis does not bode well for the older employee cohort. It does, though, highlight the economic and demographic changes that underlie the debate over CB plan conversions. The older employee cohort entered the workforce at a time when large, well-established employers valued long-term employee commitment and chose to offer TDB plans, at least in part, to reinforce that commitment. The older employee cohort and the employers both understood that the implicit terms of TDB plans traded the long-term work commitment for the promise of rapidly accelerating benefit accruals late in a long-term employee's career. When the economics of the situation change, the terms of the plans and the law permit employers to amend or terminate the plans in order to defeat that implicit bargain.

The unilateral imposition by the employer of a change in the terms of that bargain feels unfair to many observers of CB plan conversions. To put it in human terms recall some of the specific examples cited by employees who have been affected by plan conversions of TDBs. There was the twenty-eight year employee who testified that he lost "approximately 30% of the value of my pension, which translates into a lump-sum dollar loss well in

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296. See *supra* Part II.A (examining the legal challenges to plan conversions).

excess of \$400,000<sup>297</sup> in a plan conversion. Other workers have explained the effects as follows: "I am a 25 year Bell Atlantic employee who has had his pension cut about 30%,"<sup>298</sup> "[m]y best estimate is that the change will cost me about \$7500/year when I retire,"<sup>299</sup> and "[t]he end result is that I have lost 41-42% of my age—65 annual pension benefit."<sup>300</sup>

## VI. CONCLUSION

The questions left are: (1) who will bear the costs of plan promises that were made when workplace economics were very different than they are today, and (2) how directly is our system willing to acknowledge those costs? The response to the first question is that, in the environment of CB plan conversions, the burden will fall on the older employee cohort either alone or on a shared basis with those who hold the firm's stock at the time the costs become evident. From a policy perspective, is it appropriate to pass some of the burden to those shareholders? Is that part of the risk they assumed when investing in the stock? If so, then substantive regulation is necessary in order to ensure they bear a portion of the burden. If not, then the least cost option for the older employee cohort is to maintain the status quo.

Direct acknowledgement of the costs associated with maintaining or converting TDB plans brings to the forefront policy concerns about the voluntary system of employer-sponsored retirement plans. If the terms of employment in U.S. workplaces are, in fact, being restructured due to changing economic and demographic factors, to what extent should the burden of restructuring fall on the older employee cohort?

The U.S. pension system has now been through two periods since ERISA's enactment in 1974 when significant numbers of plans made changes that have allegedly defeated the implicit contract between employers and employees. The first period occurred during the terminations and reversions of the early- and mid-1980s. The second period is the current trend to CB plan conversions. During each period, affected older employees complained vociferously about the unfairness of the apparently legal plan changes, and gained some level of public support for their position. Is the implication that ERISA should not permit plan amendments that defeat long-term benefit expectations? If ERISA should be amended, how could it possibly define the difference between legitimate long-term expectations and

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297. *The Cash Balance Conundrum*, *supra* note 9, at 3 (statement of James A. Bruggeman, Employee of Central and South West Corporation).

298. *Archived Guestbook*, *supra* note 222 (Comment of Gregg Heinold on Oct. 15, 1999).

299. *Id.* (Comment of Larry Franks on Oct. 8, 1999).

300. *Id.* (Comment of John Staudt on Sept. 28, 1999).

employee misconceptions about the scope of an employer's right to amend its plan? More importantly, what effect would such a limitation have on the already beleaguered TDB system?

The answers, if they exist, are beyond the scope of this article. However, it is critical that policy makers recognize the implications of the various legislative actions that might be taken in response to the CB conversion controversy. The recent regulatory trend is to look to disclosure to address perceived problems in the benefits system.<sup>301</sup> In some instances that may, in fact, be a successful approach to accomplish its goal. Given the economic and demographic pressures that underlie the conversion of TDB to CB plans, the voting model that developed in this Article predicts that enhanced disclosure does not and would not substantially affect either the pace or the terms of plan conversions.

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301. See, e.g., Amendments to Summary Plan Description Regulations, 29 C.F.R. § 2520, 65 Fed. Reg. 70,226 (2000) (expanding disclosure requirements for health care plans); Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMP. & LAB. L. 1, 46-48 (2002).